ACCOUNTABILITY TO AMERICA

DEPARTMENT OF THE NAVY | FISCAL YEAR 2020 AGENCY FINANCIAL REPORT



PEOPLE




PROCESSES




CAPABILITIES

TABLE OF CONTENTS

Two P-8A Poseidon aircraft assigned to the "Grey Knights" of Patrol Squadron (VP) 46 sit on the flight line at Naval Air Station Sigonella, Italy. (U.S. Navy photo by Mass Communication Specialist 3rd Class Zachary Dalton)

MESSAGE FROM THE SECRETARY OF THE NAVY

America has a proud maritime history, and we have staked our principles of freedom on boldly projecting sea power through a strong, capable, and well-resourced Navy and Marine Corps. The Department of the Navy (DON) operates in an increasingly complex global environment characterized by a great power dynamic that has emerged over the last decade, a shadowy battle for information supremacy, and a continuing emphasis on speed and efficiency of operations. These elements take on heightened importance in the context of the global COVID-19 pandemic. In these uncertain times, the DON has demonstrated an agility and ability to pivot rapidly to maintain superiority over the seas while safeguarding the health of its Sailors and civilians.

The DON'S Agency Financial Report (AFR) documents our efforts to transparently manage our resources for maximum impact, it reaffirms our ongoing commitment to the American people to provide a frank, honest accounting of how we are using taxpayer dollars entrusted to us. The DON'S financial management transformation initiative is our strategy for improving stewardship and becoming a more efficient and nimble agency—one that applies industry solutions to help respond quickly and intelligently to imminent threats while achieving full visibility into its assets and resource needs. In the process, we continue to operate in lockstep with the mission and objectives outlined in the National Defense Strategy.

As we complete our third full year under full financial statement audit, we continue to hold ourselves accountable for understanding and addressing the findings presented by the auditors. The Navy and Marine Corps have benefitted greatly from these audits, and our team is aggressively working to remediate the root causes of the discrepancies found by our auditors. Auditor findings highlight opportunities for operational and process improvements, and we are capitalizing on them. The leadership of the Navy and Marine Corps embrace the lessons learned from the audit as a means of improving our warfighting capability and readiness and demonstrating excellence. We are collectively making progress to address the auditors' findings and supporting USMC's goal of attaining a positive opinion next year.

A significant portion of the Navy is forward deployed, spending longer times at-sea with fewer port visits. Thanks to sustained support from Congress, we are able to prioritize readiness and Fleet improvements that will carry our mission forward. We will continue striving to improve the way we operate and position ourselves for unwavering success on the global stage. Our ability to harness and use our resources and information will shape our success in equipping and driving our remarkable Fleet and the extraordinary, resilient men and women serving aboard in the defense of our great nation.

Kenneth J. Braithwaite
Secretary of the Navy
December 11, 2020

THIS PAGE INTENTIONALLY LEFT BLANK

The Independence variant littoral combat ship USS Independence (LCS 2), sails in the eastern Pacific.
(U.S. Navy photo by Chief Mass Communication Specialist Shannon Renfroe/Released)

MANAGEMENT'S DISCUSSION AND ANALYSIS

ABOUT THIS REPORT

The purpose of the Agency Financial Report (AFR) is to outline how the Department of Navy[1] (DON) has used Federal resources, highlight accomplishments, and represent the financial position. The DON's financial position includes, but is not limited to, financial statements, notes to the financial statements, and the Independent Public Accountant (IPA) report. This AFR provides high-level performance and management results for two separate sets of financial statements: (1) United States Navy (USN) General Fund (GF) - capturing core USN administrative and operational tasks and (2) DON Working Capital Fund (WCF) – capturing business-like acquisition and repair activities for the USN and United States Marine Corps (USMC) funded through sales revenue, rather than direct Congressional appropriations.

Information for USN GF and DON WCF are combined within the Management's Discussion and Analysis (MD&A) Section and presented separately throughout the remaining sections of this AFR. Although part of the DON, the USMC is currently audited as a standalone entity and produces a separate AFR and GF financial statements.

This report satisfies the reporting requirements contained in the following laws and regulations:

- Chief Financial Officers (CFO) Act of 1990;
- Federal Managers' Financial Integrity Act of 1982 (FMFIA);
- Federal Financial Management Improvement Act of 1996 (FFMIA);
- Government Performance and Results Act of 1993 (GPRA);
- GPRA Modernization Act of 2010;
- Government Management Reform Act of 1994 (GMRA);
- Office of Management and Budget (OMB) Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Controls (OMB A-123); and
- OMB Circular A-136, Financial Reporting Requirements; and Reports Consolidation Act of 2000 (OMB A-136).

1 When used in this document, DON applies to both the USN and USMC WCF and is not intended to discuss items presented in the USMC GF AFR.

An MH-60S Sea Hawk conducts a vertical replenishment-at-sea.
(U.S. Navy photo by Mass Communication Specialist 3rd Class Dalton Reidhead/Released)

MISSION AND ORGANIZATION

On October 13, 1775, the Continental Congress authorized the creation of the first American naval force, the precursor to the USN. This naval force was disbanded after the Revolutionary War. President John Adams signed a Congressional Act on April 30th, 1798 establishing the formation of the DON. In 1834 the USMC was incorporated into the DON. The DON remained its own standalone department until the establishment of the National Security Act of 1947, which unified the military agencies by joining the DON, U.S. Army, and U.S. Air Force as component services under the Department of Defense (DoD). Today, the DON operates under the statutory authority provided by Title 10 United States Code Subtitle C (10 USC Subtitle C).

The DON's core responsibility is to deter aggression and, if deterrence fails, win the nation's wars. The DON employs the global reach and persistent presence of forward-stationed and rotational forces to secure the nation from direct attack, assure joint operational access, and retain global freedom of action. Along with global partners, the DON protects the maritime freedom that is the basis for global prosperity and fosters and sustains cooperative relationships with an expanding set of allies and international partners to enhance global security.

MISSION

To recruit, train, equip and organize to deliver combat ready Naval forces to win conflicts and wars while maintaining security and deterrence through sustained forward presence.

VISION

A combat credible Navy and Marine Corps Team focused on rebuilding military readiness, strengthening alliances, and reforming business practices in support of the National Defense Strategy.

Organization

The organization of the Navy is prescribed in 10 USC Subtitle C, Part I. The Secretary of the Navy (SECNAV) is responsible for, and has authority to, conduct all affairs of the DON. The SECNAV oversees the construction, outfitting, and repair of naval ships, equipment and facilities, and is responsible for the formulation and implementation of policies and programs. Under the purview of the SECNAV are the Under Secretary of the Navy, four Assistant Secretaries of the Navy, General Counsel, Chief Information Officer (CIO), and two key military leaders—the Chief of Naval Operations (CNO) and Commandant of the Marine Corps (CMC) who are responsible for the command, operating efficiency and performance of combined forces that consists of approximately 725,000 active duty (including Officers, Enlisted, and Midshipmen), Reserve and civilian forces.

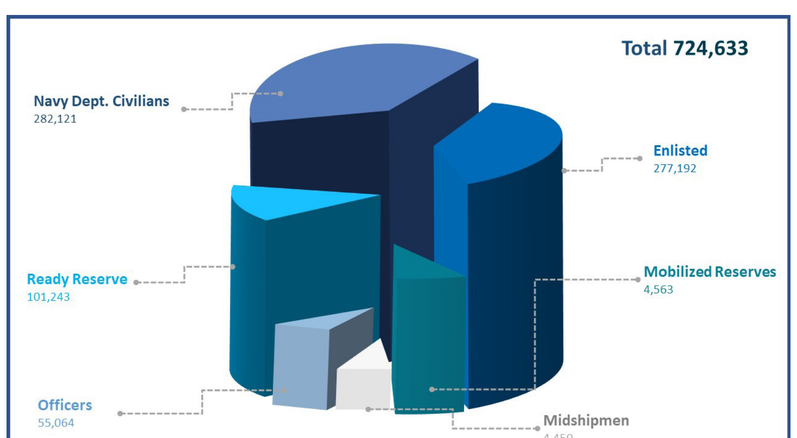
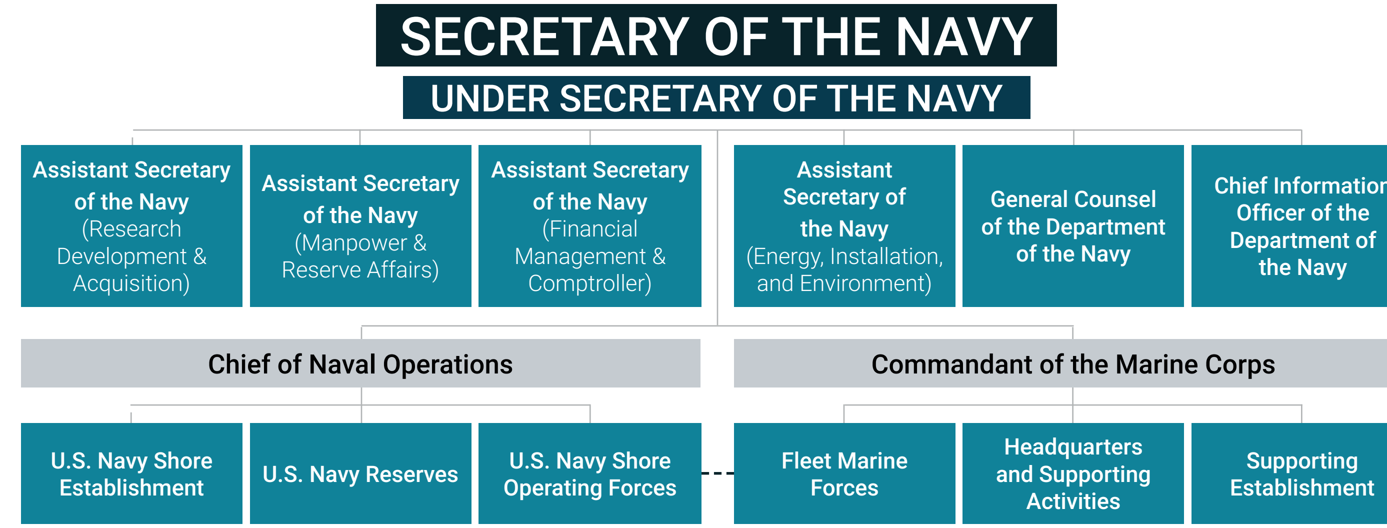


Figure 1: DON Organization Chart



** Dashed line signifies collaboration of the U.S. Navy and the U.S. Marine Corps operating forces.*

Mission Areas

All components of the DON are organized to respond to a broad range of mission priorities that preserve the Nation's freedom and protect U.S. global interests. The Office of the Secretary of the Navy has sole responsibility within the DON for acquisition, audit, environmental protection and conservation, financial and information management, installation and infrastructure support, legislative affairs, personnel recruitment, public affairs, research and development, and safety and occupational health. The CNO is responsible for the command, utilization of resources, and efficiency of operating forces and shore activities assigned by the Secretary of Defense (SECDEF). Like the CNO, the CMC oversees various commands that operate under the authority and responsibility of a commander and typically support a network of subordinate commands. Both Services provide ready forces to support the U.S. joint military commands in conducting worldwide missions.

In support of the DON's mission areas, there are three major CNO components: shore, reserves, and the supporting operations:

U.S. Navy Shore Establishment. Provides the fleet the personnel and resources needed to deter threats and win wars. The USN Shore Establishment support the fleet through the repair of ships, aircraft, weapons, machinery and electronics; communications; naval personnel support; installation and infrastructure support; intelligence, meteorological, and oceanographic support; and legal services.

U.S. Navy Reserves. Delivers strategic and operational capabilities to the Navy and Marine Corps team and Joint forces, in times of peace or war. Reservists seamlessly support and actively aid that mission, all while continuing to lead their own independent lives in the civilian world.

U.S. Navy Operating Forces. Leads the combat and combat support arm of the DON. These operating forces carry out naval operations needed to support the DON's role in upholding and advancing the national policies and interests of the U.S. They have two organizational chains of command - (1) Permanent administrative chain of command through the CNO to the SECNAV, and (2) Operational chain of command through the Unified Combatant Commands (UCCs) to the SECDEF.

These three components carry out naval operations needed to support the DON's role in upholding and advancing the national policies and interests of the U.S. Each component oversees various commands that each have a clearly defined mission in support of the overall DON mission. Within those commands are Budget Submitting Offices (BSO), which are functionally classified across three basic domains: Acquisition, Operating Forces, and Support. Below outlines each domain's purpose and each BSO's distinct mission.

Acquisition BSOs act for and exercise the authority of the Navy Acquisition Executive to manage assigned programs and projects, which generally run the full cycle of requirements development. Except for the Strategic Systems Program, these BSOs are also referred to as systems commands (SYSCOMs). SYSCOMs are the materiel commands of the USN responsible for the design, construction, and maintenance of military systems such as ships, aircraft, and weapons. The USN's Acquisition BSOs are listed below.

Naval Air Systems Command (NAVAIR) is the principal provider for the Naval Aviation Enterprise, which maintains top combat effectiveness by smartly managing precious resources and attack readiness degraders, while collaborating across organization boundaries to deliver ready forces where and when they are needed. NAVAIR provides support to Naval Aviation Program Executive Officers.

Working Capital Fund Operations

NAVAIR operates the Naval Air Warfare Centers (NAWCs) and the Fleet Readiness Centers (FRCs) using a WCF. The portion of NAVAIR's BSO supporting these WCF activities are reported within the DON WCF financial statements. NAVAIR operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Naval Sea Systems Command (NAVSEA) is the largest of the USN's SYSCOMs and is responsible to design, build, deliver, and maintain ships, submarines, and systems reliably, on-time and on-cost for the DON.

Working Capital Fund Operations

NAVSEA operates the Naval Surface Warfare Centers (NSWCs) and the Naval Undersea Warfare Centers (NUWCs) using a working capital fund model and are reported within the DON WCF financial statements. NAVSEA operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Naval Supply Systems Command (NAVSUP) provides supplies, services, and quality-of- life support to the Navy and Joint warfighter. NAVSUP oversees supply chain management for materiel support to Navy, Marine Corps, Joint and coalition partners, supply operations, conventional ordnance, contracting, and quality-of-life issues for naval forces.

Working Capital Fund Operations

NAVSUP operates the Business Systems Centers (BSCs) and Weapons Systems Support (WSS) using a working capital fund. The portion of NAVSUP's BSO supporting these WCF activities are reported within the DON WCF financial statements. NAVSUP operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Naval Information Warfare Systems Command (NAVWAR) identifies, develops, delivers, and sustains information warfare capabilities and services that enable naval, joint, coalition and other national missions operating in war fighting domains from seabed to space; and performs such other functions and tasks as directed.

Working Capital Fund Operations

NAVWAR operates the Naval Information Warfare Centers (NIWCs) using a working capital fund. The portion of NAVWAR's BSO supporting these WCF activities are reported within the DON WCF financial statements. NAVWAR operations other than the aforesaid activities are general fund operations and consolidated in the USN GF financial statements.

Strategic Systems Program (SSP) directs the end-to-end effort of the Navy's Strategic Weapons Systems (SWS) to include training, systems, equipment, facilities and personnel; and fulfill the terms of the U.S./United Kingdom Polaris Sales Agreement.

Marine Corps Logistics Command (MARCORLOGCOM) provides globally responsive ground equipment inventory control and integrated operational-level logistics capabilities in order to maximize Marine Corps materiel readiness and sustainment.

MARCORLOGCOM is a WCF component of the USMC BSO. The USMC GF is reported in the USMC AFR.

Support BSOs support programs such as medical, infrastructure, science and technology (S&T), intelligence, and SECNAV and CNO staff office support. The USN's Support BSOs are listed below:

Bureau of Naval Personnel (BUPERS) provides administrative leadership, policy, planning, general oversight, training, and education for all Navy personnel. This includes developing, monitoring, and revising Navy strength plans for all active duty and ready reserve military personnel.

Commander, Navy Installations Command (CNIC) is responsible for worldwide U.S. Navy shore installation management, designing and developing integrated solutions for sustainment and development of Navy shore infrastructure. CNIC also has oversight of Naval Facilities Engineering Command (NAVFAC) which plans, builds, and maintains sustainable facilities. In FY 20, the Naval Facilities Engineering Service Center (FEC) activities were moved from the DON WCF to the USN GF.

Working Capital Fund Operations

In FY 20, the Engineering and Expeditionary Warfare Center (EXWC) was realigned from Base Support to Research and Development in the DON WCF.

Bureau of Medicine and Surgery (BUMED) is a global health care network that provides health care support to the USN, USMC, their families, and veterans, through the Defense Health Program (DHP) and coordinated by the Office of Assistant Secretary of Defense (Health Affairs) with support from the Defense Health Agency (DHA).

Office of Naval Research (ONR) sponsors research across a wide array of critical scientific disciplines, working with experts from industry, academia, naval warfare centers, laboratories, and other innovative organizations.

Working Capital Fund Operations

ONR operates the Naval Research Laboratory (NRL) using a working capital fund. The portion of ONR's BSO supporting this WCF activity is reported within the DON WCF financial statements. ONR operations other than the aforesaid activity is general fund operations and consolidated in the USN GF financial statements.

Naval Intelligence Activity (NIA) directs, synchronizes, and manages the Naval Intelligence Enterprise. NIA executes the Navy's intelligence resources, aligning national-level and departmental allocations and efforts. NIA specializes in the oversight, collection, counterintelligence, and security activities of Naval Intelligence.

Field Support Activity (FSA) establishes, maintains, and provides a system of financial services as a BSO - Principal Administering Office for assigned combatant commands, Navy Headquarters and activities. FSA initiates actions pertaining to the provision of funds and manpower, evaluates the utilization of such resources, and initiates or recommends appropriate corrective actions.

Secretariat Comptroller Division (FMB-7) resides in the Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (FM&C) organization and serves as the Comptroller for the Navy Secretariat comprising four ASNs, one Deputy Under Secretary of the Navy (DUSN), a General Counsel (GC) team and ten supporting organizations.

Operation forces BSOs support programs and projects once they are fielded and fully operational. The USN's operating forces BSOs are listed below:

U.S. Fleet Forces Command (USFLTFORCOM) trains, certifies and provides combat-ready Navy forces to combatant commanders that can conduct prompt, sustained naval, joint, and combined operations in support of U.S. national interests. USFLTFORCOM also commands and controls subordinate Navy forces and shore activities during the planning and execution of assigned service functions in support of the Chief of Naval Operations (CNO).

Working Capital Fund Operations

USFLTFORCOM also operates the Military Sealift Command (MSC) which operates, supplies, and maintains the Naval ships around the world. The portion of USFLTFORCOM's BSO supporting this WCF activity is reported within the DON WCF financial statements. USFLTFORCOM operations other than the aforesaid activity is general fund operations and consolidated in the USN GF financial statements.

Commander, U. S. Pacific Fleet (COMPACFLT) protects and defends the collective maritime interests of the U.S. and its allies and partners in the Asia-Pacific region. COMPACFLT is the world's largest fleet command, encompassing 100 million square miles or more than half the Earth's surface.

Commander, Navy Reserve Force (CNRF) delivers strategic depth and operational capability to the Navy, Marine Corps, and Joint Forces by providing mission-capable units and individuals in support of the full range of operations, from peace to war.

Composition of Support to Unified Combatant Commands

The DON is also supported by Unified Combatant Commands (UCCs) which are DoD commands comprised of forces from at least two military Departments with a broad and continuing mission. These commands are established to provide effective command and control of U.S. military forces to include elements of the DON. UCCs are organized on either a geographical basis (i.e., possessing an area of responsibility) or a functional basis (i.e., providing a capability). The USN maintains operational forces and units that are operationally aligned to UCCs and centrally funded by the DoD and other military service components. Unless otherwise specified, all organizations supporting UCCs are centrally funded by the DoD and not reporting entities under the DON.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

America's security depends on the strength and success of the DON and its ability to remain ahead of the competition. The DON set a strategy for restoring readiness, strengthening partnerships and reforming its business practices, centered on three key priorities: people, processes, and capabilities. The focus of these priorities is to restore program balance, sustain global demand for naval forces, continue improving readiness, recapitalize and modernize naval forces, address the competitive operational environment, improve cyber resiliency, and promote responsible military spending. These efforts will enhance capabilities, improve the lives of Sailors and Marines, and increase lethality, resulting in the successful sustainment of our world-class naval force and greater security for the U.S.

In line with the National Defense Strategy, the Navy created the DON Business Operations Plan (BOP) in FY 2018 which established prioritized strategic objectives along with focus areas and specific initiatives to achieve those objectives and support vital integration efforts. The BOP is an agile, guiding tool, not an immovable strategy. Indeed, to be successful, DON objectives and timelines will adapt and evolve along with the demands of the institution to reflect changes in the DON's external environment and capabilities of both partners and adversaries.

One of the Navy's objectives is to improve business and financial performance that will be affirmed through full financial statement auditability. The DON is committed to promoting a business culture in which all participants understand their respective roles in achieving and sustaining financial auditability, beginning with senior leaders and extending to business managers who support warfighters each day. Given the complexity and scale of the DON's operating environment, the Navy implemented several long-term transformation initiatives that are designed to integrate, standardize, and modernize enterprise systems; improve visibility and transparency of business data; and institutionalize effective internal controls over business processes. While the transformation effort is ongoing, the audit is proving to be a valuable independent assessment that the DON can leverage to support readiness and lethality. DON is using this information to streamline operations and reimagine how support functions can be modernized.

Finally, this plan will adapt and evolve along with the demands of the institution, enabling improved readiness and lethality while creating greater agility and accountability. The initial BOP, published October 2018, promulgated the Secretary's vision to every echelon, and detailed the many outstanding initiatives throughout the Department, while measuring performance against plans. The FY 2020-2022 DON BOP links the DON's strategic vision and operations, and promotes continuous learning, evolution, and growth as one naval team that continues to deliver combat-ready naval forces.

The DON Business Operations Management Council (BOMC) and the Office of the Chief Management Officer (OCMO) regularly track performance of initiatives contained within the BOP. The BOMC discusses these initiatives from a risk-based perspective within the context of the National Defense Strategy. The DON uses status reports on each initiative to identify risks to the successful completion of a strategic objective and discusses what resources and authorities may be required to ensure success.

During FY 2020, the DON completed 38 BOP initiatives. Some of the most notable successes over the last year include:

- Developed and promulgated a DON Data Architecture to enforce investments, systems development, and Program Objective Memorandum (POM) planning
- Migrated three WCF organizations to Navy ERP
- Designed, developed, implemented, and tested internal controls to sustain accountability of assets
- Finalized implementation of the ASN (RD&A)'s new Title 10 sustainment responsibilities with stand-up of DASN (Sustainment)
- Developed a reporting process to track data rights challenges and their resolutions in order to inform DON data rights strategies during acquisition planning and contract performance, as well as to inform DON legislative and regulatory priorities
- Developed an Office of General Counsel (OGC) trademark docketing system to track registration of DON trademarks and oppositions to protect DON trademarks including the ability to obtain royalty payments

The DON BOP, now entering its fourth year, includes 230 initiatives, encompassed under 36 larger focus areas that will be monitored throughout the fiscal year, and continues to harness the momentum of its successes. The DON BOP was updated in FY 2019 to help articulate the impact each initiative has on the strategic objectives. For FY 2020, new business rules have been established which require initiatives to provide impact in one of three ways: (1) cost savings, investments, or avoidance; (2) manpower or time savings and efficiencies; (3) or as enablers that affect readiness and lethality. The following discussion and tables provide a high-level overview of the BOP framework and foundation for the DON's ongoing management agenda, focusing on the three lines of effort, strategic objectives, and sample results. For more information, the DON BOP is available at https://www.secnav.navy.mil.bop.

Line of Effort 1: Rebuild Military Readiness as We Build a More Lethal Joint Force

The pace of wartime and other priority worldwide operational programs has taxed the DON's capacity to maintain a ready force. The current and planned budgets deliberately prioritize improved readiness and integration of current Navy Operating and Fleet Marine Forces. The DON BOP promotes adjustments to business processes and inserts innovative, more efficient means to assess progress, so that every taxpayer dollar is stewarded effectively in support of DON warfighters. The continued overall improvement of military readiness will take time, and the investments will be more properly balanced across all the dimensions of naval power to consistently meet national strategic objectives.

Select FY 2020 Results for Line of Effort 1

STRATEGIC OBJECTIVE		SELECTED RESULT
1.1.A	**Fully restore aviation/ship/personnel Readiness to meet missions**	Finalized implementation of ASN (RD&A)'s new Title 10 sustainment responsibilities with stand-up of DASN (Sustainment)
1.1.B	**Restore inventory of weapons and ammunition to meet warfighting requirements**	U.S. Fleet Forces Command and U.S. Pacific Fleet released a new munitions Allocations Process Instruction to establish fleet policy and assign responsibilities associated with allocating, prioritizing, and distributing available conventional ordnance for those munitions delivered to the Fleet as a result of the POM process
1.2.A	**Deliver platforms that possess greater combat power and longer reach in support of Missions across all domains**	Developed a reporting process to track data rights challenges and their resolutions in order to inform DON data rights strategies during acquisition planning and contract performance, as well as to inform DON legislative and regulatory priorities
1.2.B	**Deliver innovative technologies that provide greater combat power and longer reach in support of missions across all domains**	Developed an OGC trademark docketing system to track registration of DON trademarks and oppositions to protect DON trademarks including the ability to obtain royalty payments
1.2.C	**Develop and implement a sustainable path to infrastructure modernization**	Improved installation resilience posture for energy, utilities, and environment in order to increase DON mission assurance at key mission critical facilities
1.3.A	**Optimize DON's information infrastructure (e.g., networks, transport, end-user hardware, spectrum)**	Improved installation resilience posture for energy, utilities, and environment in order to increase DON mission assurance at key mission critical facilities
1.3.B	**Increase DON's ability to deter, detect, defeat and recover from cyber-attacks**	Completed first installation of Navy Situational Awareness, Boundary Enforcement and Response (SABER) capability
1.4.A	**Deliver timely and relevant intelligence, counterintelligence and security support to Sailors and Marines to provide a decisive and dominant advantage**	Created a DON Insider Threat Hub to Initial DUSN Operating Capability (IOC)
1.5.A	**Produce a highly skilled workforce (Sailors, Marines, and civilians) shaped for today and prepared for tomorrow's needs**	Improve and modernize military personnel management operations through increased automation and process improvements, by implementing a detailing marketplace and by enhancing career flexibility through rating modernization

Table 1: FY 2020 Results for Line of Effort 1

Line of Effort 2: Strengthen Our Alliances and Attract New Partners

The DON's security cooperation efforts are designed to sustain and enhance the DON's primary missions, as well as nurture allied and friendly naval force capability and capacity for self-defense and multilateral operations. This entails working with allies and partners to collaborate in a variety of areas, including facilitating interoperability with naval forces, ensuring and exercising port access, and providing partner naval forces access to naval capabilities and technologies.

The U.S. has a thriving, global constellation of alliances and partnerships that provides an asymmetric advantage no competitor or adversary can match. DON takes that advantage seriously and is dedicated to fostering its growth at every opportunity.

Select FY 2020 Results for Line of Effort 2

STRATEGIC OBJECTIVE		SELECTED RESULT
2.1.A	**Implement a more strategic, coordinated approach to security cooperation**	Implemented security cooperation activities that counter Chinese and Russian efforts to influence nations; that enable partners to counter threats from Iran and North Korea; and that ensure US access to enable a superior geo-strategic position over adversaries

Table 2: FY 2020 Results for Line of Effort 2

Line of Effort 3: Reform the Department's Business Practices for Greater Performance and Affordability

The DON realigns incentive and reporting structures to increase speed of delivery, enables design tradeoffs in the requirements process, expands the role of warfighters and intelligence analysis throughout the acquisitions process, and utilizes non-traditional suppliers. Prior to defining requirements and using commercial-off-the-shelf systems, the DON uses prototyping and experimentation. Creating a culture of agility, accountability, and continuous learning allows the DON to accomplish business reform objectives. In doing so, the DON is able to build a flatter and faster organization in which data is verified, processes are clear and understood, and business controls lead to informed decisions.

Select FY 2020 Results for Line of Effort 3

STRATEGIC OBJECTIVE		SELECTED RESULT
3.1.A	**Increase the use of data analytics and artificial intelligence in DON-wide decision making**	Developed and promulgated a DON Data Architecture to enforce investments, systems development, and POM planning
3.1.B	**Reform business operations enterprise-wide to generate lasting, institutionalized, resources to support strategic reinvestment in lethality**	Created a cadre of supporters who can educate and advocate for small business by selecting five acquisition professionals annually to participate in the Office of Small Business Programs (OSBP) rotational excellence program
3.2.A	**Reduce redundancies across the enterprise (to include Office of the Chief of Naval Operations (OPNAV), Marine Corps Headquarters (HQMC) and DON Secretariat) to achieve cost savings and improve agility**	Established a Naval Community College
3.3.A	**Institutionalize annual audit and remediation, and establish a near term path to a clean opinion**	Migrated non-ERP legacy accounting systems to the Standard Accounting, Budgeting, and Reporting System (SABRS)

Table 3 FY 2020 Results for Line of Effort 3

LOOKING FORWARD

The Navy and Marine Corps team is the most lethal and ready forward deployed force in the world and operates in an increasingly complex global security environment. To succeed, DON must remain agile and improve at the speed of relevance. DON will continue to work with partners, including international allies and industry, to become more agile, compete in ways that are more sustainable, and control the high end of the conflict as part of the DoD and alongside our allies and partners.

External factors that challenge DON's ability to achieve its strategic goals include:

- Reemergence of long-term, strategic competition, including Russia and China against a resilient, but weakening, post-WWII international order.
- Regional destabilization driven by rogue regimes, including North Korea and Iran, and the continued pursuit of weapons of mass destruction.
- Erosion of DON technological gap through rapid, commercially driven technological advancements and the changing character of combat.
- Threats from non-state actors, including terrorists, trans-national criminal organizations, cyber hackers, and other malicious non-state actors which target America.
- Increased domestic activity eroding the sanctuary of America, including terrorism, malicious cyber activity, and political and information subversion.
- Economic and labor market changes that impact the availability of a quality workforce to meet DON demands.

To address these risks, the DON BOP identified planned actions for three National Defense Strategy Lines of Effort that each encompass more specific strategic objectives:

Rebuild Military Readiness as We Build a More Lethal Joint Force

- **Restore Military Readiness to Build a More Lethal Force.** In FY 2021, attention will be placed on efforts to improve the readiness of the surface and subsurface warfare enterprise by closely managing ship schedules to ensure timely maintenance.
- **Enhance IT and Cybersecurity Capabilities.** In FY 2021, the DON is focusing on data center optimization while accelerating its transition to a more secure and efficient cloud service.

Strengthen our Alliances and Attract New Partners

- **Reform the Security Cooperation Enterprise.** In FY2021, the DON is working to develop policies to clarify priorities, leverage authorities, and sharpen tools to enhance global naval security initiatives.

Reform the Department's Business Practices for Greater Performance and Affordability

- **Improve and strengthen Business Operations through a move to DoD-Enterprise or Shared Services; Reduce Administrative and Regulatory Burden.** In FY 2021, the goal will be to develop the DoD Data Strategy that will solely focus on governance, workforce readiness, and tools/technology.
- **Improve the Quality of Budgetary and Financial Information that is most valuable in managing the DoD.** The elimination of multiple of accounting systems with the goal of transitioning to one system is forefront for the DON during this fiscal year. DON is working to expand to Navy ERP to include processing receipt, acceptance, and Treasury disbursement operations for vender and contract payments.

FY2020 ASSURANCE STATEMENT

THE SECRETARY OF THE NAVY
WASHINGTON DC 20350-1000

FOR: SECRETARY OF DEFENSE

FROM: Kenneth J. Braithwaite, Secretary of the Navy OCT 1 2020

SUBJECT: Annual Statement Required Under the Federal Managers' Financial Integrity Act for Fiscal Year 2020

- Mr. Secretary, I recognize the importance of managing the Department of the Navy's (DON) risks and maintaining effective internal controls to comply with Sections 2 and 4 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The DON conducted its risk and internal control assessment in accordance with the Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, and the Government Accountability Office (GAO) Publication GAO-14-704G, Standards for Internal Control in the Federal Government.
- Based on the results of the DON Internal Controls Over Operations (ICO) assessment, as of the date of this memorandum, the DON can provide reasonable assurance, except for the nine Material Weaknesses (MWs) and two Significant Deficiencies reported in the "Material Weaknesses and Significant Deficiencies" section, that ICO and compliance were operating effectively as of 30 September 2020.
- Based on the results of the DON Internal Control over Financial Reporting assessment, the DON is unable to provide assurance that controls were operating effectively due to the 12 MWs reported in the "Material Weaknesses" section as of 30 September 2020, in accordance with OMB Circular No. A-123, Appendix A.
- Based on the results of the DON Internal Controls Over Financial Systems assessment, the DON is unable to provide assurance that controls were operating effectively due to the three MWs reported in the "Material Weaknesses" section as of 30 September 2020, in accordance with FMFIA and OMB Circular No. A-123, Appendix D.
- The DON assessed Entity Level Controls (ELCs), including fraud controls, in accordance with Section 10.09 of GAO's, Standards for Internal Control in the Federal Government (the "Green Book"), OMB Circular No. A-123, the Payment Integrity Information Act of 2019, and GAO Fraud Risk Management Framework. Based on the results of the assessment, the DON can provide reasonable assurance, except for one Oversight and Monitoring MW that ELCs, including fraud controls, are operating effectively as of 30 September 2020. The annex of classified and Special Access Programs (SAP) MWs has been forwarded through special access to the Office of the Secretary of Defense SAP Classified Office.
- My point of contact for any questions regarding the Statement of Assurance for Fiscal Year 2020 is Mr. Gregory G. Koval, who may be reached at (703) 685-6720 or e-mail at gregory.koval l@navy.mil.

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

Quantifiable financial information, in conjunction with sufficient controls, provides valuable information to complement operational data and promotes a greater understanding of process efficiency and resource utilization. FFMIA, FMFIA, and OMB A-123 provide the framework to create an environment which allows the production of timely, reliable, and accessible financial information; implementation of effective and efficient internal controls; and a risk management process designed to support DON achievement of strategic objectives.

The DON Commanders, senior leaders, and managers are obligated to safeguard the integrity of the programs and operations. DON management evaluated the system of internal controls in effect during FY 2020 in accordance with OMB A-123 and GAO's Standards for Internal Control in the Federal Government (Green Book). The OMB guidelines were issued in conjunction with the Comptroller General of the U.S., as required by FMFIA.

Below is an abbreviated discussion; for more information, see the full FY 2020 DON Statement of Assurance (SOA).

Corrected and Reassessed Material Weaknesses

The two material weaknesses listed below were reported by the independent financial statement auditor in FY 2019, which occurred after the FY 2019 Statement of Assurance (SOA) was issued. The DON was able to remediate these issues in FY 2020 through process improvements and system upgrades and are not reported as current year MWs in the FY 2020 SOA:

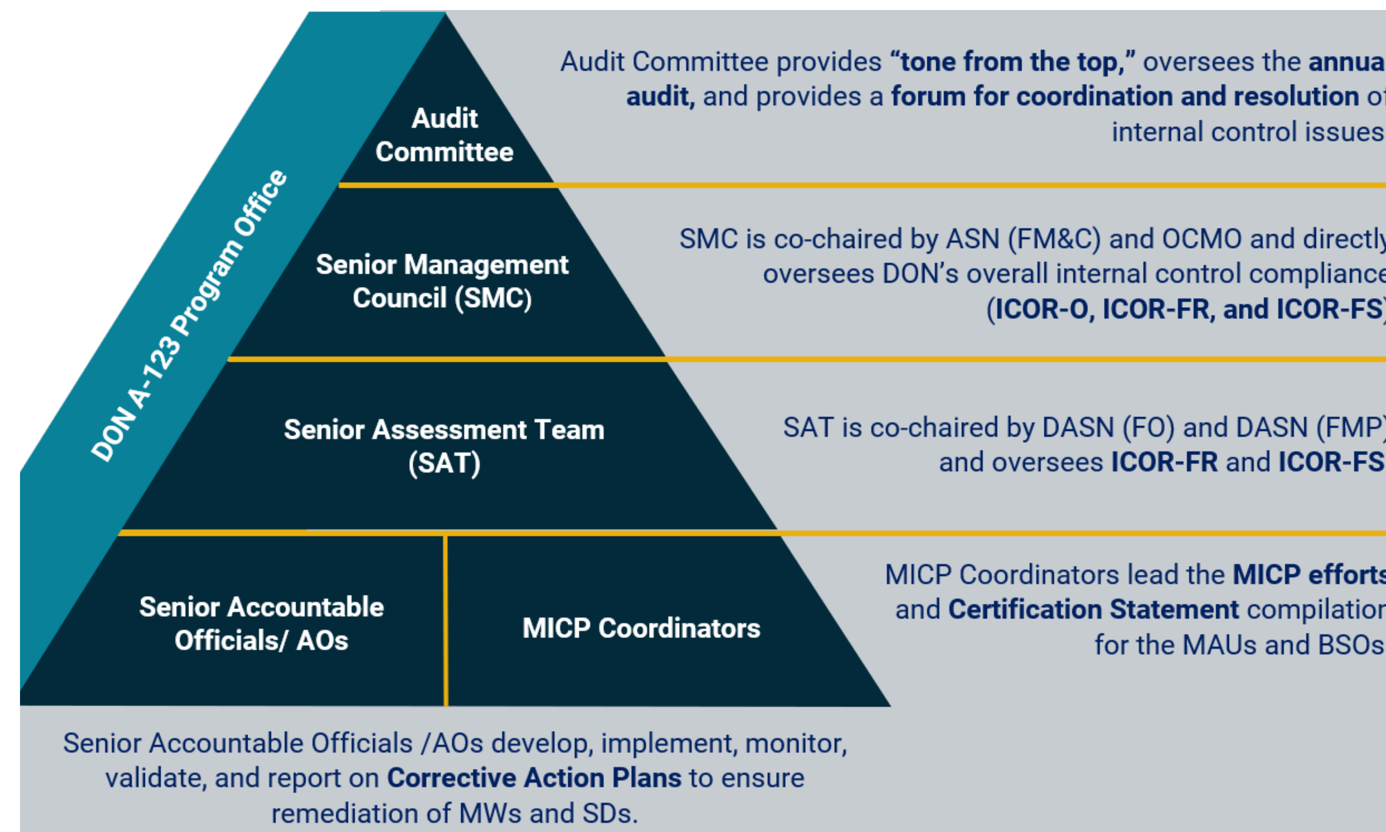
Corrected and Reassessed Prior Year MWs				
Area	**Internal Control Reporting Category**	**Title of Material Weakness**	**Targeted Correction Year**	**Status**
Internal Controls Over Financial Reporting (ICOFR)	Budget-to-Report	Contingent Legal Liabilities	FY 2020	Reassessed as Significant Deficiency
Internal Controls Over Financial Reporting (ICOFR)	Budget-to-Report	Contract Authority	FY 2020	Corrected

Internal Controls Governance

This year, the DON continued to mature the DON's Internal Controls program, building upon the existing Managers' Internal Control Program (MICP) governance structure to align with FMFIA and OMB A-123 requirements. DON introduced the Integrated Risk Management Strategy (IRM) as well as the Enterprise Risk Management (ERM) Concept of Operations (CONOPS) to support the DON in moving towards accomplishing its strategic objectives to being compliant with OMB A-123 integration of ERM and ICOR. The IRM Strategy provides a roadmap for enhancing the efficiency, effectiveness, and transparency of the DON's risk management and internal control capabilities to more effectively prioritize risk response decisions. This approach is supported by four pillars including governance as well as people, processes and technology.

The DON's comprehensive internal control governance structure monitors risks, the effectiveness of internal controls, remediates deficiencies, and reports progress in the annual SOA. Governance will focus on three main bodies to support the flow of risk information and recommendations to senior leaders through the IRM approach that are supported by working level internal control monitors and the DON A-123 Program Office. The governance structure and the roles and responsibilities of each governing body is illustrated in Figure 1 below.

Figure 1: DON Internal Control Governance Structure



- **The Business Operations Management Council** will assess enterprise-level and strategic risks. The Council is chaired by the Under Secretary of the Navy and includes senior leaders from the Department. It will focus on the early identification of risk from external, strategic and internal sources.
- **The DON Audit Committee**, chaired by the Under Secretary of the Navy, representing the DON's senior-level leadership, provides dedicated oversight of internal control compliance, and oversees the annual audit of financial statements, while setting the audit response strategy and aligning its priorities. In FY 2018, the Audit Committee assigned end-to-end process owners to lead the DON's functional business process areas, including policy development, implementation, and compliance.

- **The DON's Senior Management Council (SMC)**, comprising Senior Executive Service (SES) members and flag officers from each Echelon I command, or major assessable unit (MAU), and is co-chaired by the Principal Deputy ASN (FM&C) and Director, OCMO. The SMC advises the Audit Committee on the state of the DON's internal control risk assessment, testing, compliance, corrective action implementation, and reporting. The SMC will lead the implementation of the IRM Strategy and enhance OMB A-123 evaluation program across the DON. It will report financial risks to the Audit Committee and non-financial, operational risks to the Business Operations Management Council.

The governing bodies are supported by the DON A-123 Annual Certification Statement process. Each of the DON MAUs and BSOs are assigned a MICP Coordinator that serves as the working-level internal control representatives for their organizations. The DON A-123 Program Office provides continuous support and feedback throughout the assessment process including training that focuses on the completion of the annual Certification Statement Memorandum and supporting components (i.e., MICP Plan, Risk Assessment, Internal Controls Evaluation, Material Weakness/Significant Deficiency CAPs, and Significant Accomplishments).

Internal Controls over Operations (FMFIA Section 2)

The DON's MICP is the administrative vehicle for monitoring ICO, ICOFR, and ICOFS. The DON's ICO program mitigates the risk of fraud, waste, and misuse of DON resources. The evaluation and execution of effective and efficient internal control extends to internal stakeholders and external shared service providers. Responsibility for program execution and reporting resides within a network of 18 MAUs, which includes the CNO, CMC, ASNs, Secretariat Staff Offices, and other entities that report directly to the SECNAV.

Based on the results of the assessment, the DON can provide reasonable assurance, except for the nine MWs and two Significant Deficiencies (SD) identified below, that internal controls over operations and compliance were operating effectively as of September 30, 2020 (all findings listed are material weaknesses unless denoted as "SD", indicating a significant deficiency).

Marines move into position to begin a simulated beach raid at Kin Blue, Okinawa, Japan. (U.S. Marine Corps photo by Lance Cpl. Andrew Bray)

Uncorrected ICO Material Weaknesses

Internal Control Reporting Category	Title of Material Weakness	First Year Reported	Targeted Correction Date
Multiple	Depot Level Maintenance	FY 2016	Q3 FY 2025
Personnel and Organizational Management	Military Pay and Personnel	FY 2016	Q2 FY 2025
Comptroller and Resource Management	DON Oversight and Management of Improper Payments	FY 2015	Q2 FY 2021
Contract Administration	Execution of Husbanding Contracts –Husbanding Service Providers	FY 2016	Q4 FY 2023
Multiple	Data Protection	FY 2017	Q1 FY 2021
Information Technology	Complex Business IT Environment	FY 2018	Q1 FY 2024
Multiple	Property in the Possession of Contractors	FY 2018	Q1 FY 2023
Personnel and Organizational Management	Submission of Criminal Subject Fingerprint Cards and Reporting Disposition of Criminal Charges	FY 2018	Q3 FY 2021
Security	Protection of Controlled Unclassified Information (SD)	FY 2017	Q3 FY 2021
Acquisition	Attenuating Hazardous Noise in Acquisition and Weapons System Design (SD)	FY 2017	Q1 FY 2021
Multiple	Oversight and Monitoring	FY 2016	Q1 FY 2026

The DON developed CAPs to address each of the areas above, which are managed by the appropriate MAUs across the DON. The SMC is responsible for independently monitoring and reviewing the implementation of those CAPs.

Internal Controls over Financial Reporting (FMFIA Section 2)

In FY 2020, the DON continued to build upon prior year progress in improving ICOFR, maintaining focus on its financial transformation objectives and building a robust internal control program enabling mission success and program sustainability.

The DON's BSOs define the assessable units within their organization based on those most critical to the BSO's mission and strategic objectives. The BSOs executed their internal control process, which includes a risk assessment, control testing, deficiency identification and subsequent corrective actions, and reporting results in a certification statement. These certification statements, and their supporting enclosures, combined with insight from IPA findings that shed further light on the nature and significance of the MWs are the primary source documents for the SECNAV's determination that controls are not in place to provide reasonable assurance over the effectiveness of the DON's financial operations and processes.

Based on the results of the assessment, the DON cannot provide reasonable assurance controls were operating effectively due to 12 MWs identified below as of September 30, 2020 in accordance with OMB A-123, Appendix A.

Uncorrected ICOFR Material Weaknesses

Internal Control Reporting Category	Title of Material Weakness	First Year Reported	Targeted Correction Date
Acquire-to-Retire	Property, Plant & Equipment Valuation	FY 2006	Q3 FY 2024
Acquire-to-Retire	General Equipment-Remainder – Existence and Completeness	FY 2007	Q2 FY 2021
Multiple	Financial Reporting	FY 2017	Q4 FY 2026
Multiple	Fund Balance with Treasury	FY 2016	Q4 FY 2021
Procure-to-Pay	Accounts Payable	FY 2017	Q4 FY 2023
Budget-to-Report	Traceability and Supportability of Foreign Military Sales Transactions	FY 2015	Q4 FY 2021
Procure-to-Pay	Procure-to-Pay Process	FY 2013	Q1 FY 2026
Plan-to-Stock	Inventory	FY 2005	Q3 FY 2022
Plan-to-Stock	Operating Materials & Supplies – Remainder	FY 2005	Q4 FY 2024
Plan-to-Stock	Operating Materials & Supplies – Ordnance	FY 2005	Q3 FY 2022
Order-to-Cash	Order-to-Cash Process	FY 2009	Q4 FY 2023
Multiple	Budgetary Execution	FY 2012	Q4 FY 2026

The DON has identified several remediation priority areas. By concentrating resources and management attention on these areas, the DON established a more focused and efficient approach to correcting findings and improving the reliability of its financial information. As a result, the DON expects to reduce material weaknesses in its system of internal controls, increase the accuracy of financial disclosures and, ultimately, achieve a positive audit opinion.

Each of these areas have distinct initiatives that are being worked through various remediation efforts. Significant accomplishments for FY 2020 include:

Oversight and Monitoring: Issued the DON's IRM Strategy and published the ERM CONOPS. Established a Fraud Risk Management (FRM) program and completed first phase of the DON Enterprise Governance, Risk, and Compliance (eGRC) pilot.

Government Furnished Property: Established initiatives to add more specificity to the frequency and timeliness of contractor reporting. Pilots are evaluating the impact of recommended contract changes for long-term systems improvements.

Fund Balance with Treasury (FBwT): Migrated the DON's disbursing function to the Department of Treasury's Treasury Direct Disbursing (TDD) for the OnePay and DON ERP systems. In addition, completed actions necessary to transfer balances for multiple Revenue programs out of Navy Budget Clearing (Suspense) accounts and move into appropriate DON Treasury Account Symbols (TAS). This addressed DON and DoD audit findings that identified the misuse of suspense accounts to manage revenue programs (forestry, trademarks, recycling, and agriculture/grazing leases). Further, completed actions necessary to reduce the overaged balance of Statement of Difference (SOD) variances at DON disbursing offices.

Inventory and OM&S: Navy Materiel Accountability Campaign (NMAC) clean-up efforts identified materiel that were not visible across the Navy enterprise.

Real Property: Performed 100% inventory of Real Property that resulted in improved accuracy of inventory records. There were 425 non-utility buildings/structures and 504 utilities removed from the inventory and funds earmarked to maintain/replace them ($29 million) was repurposed to other projects.

Internal Controls over Financial Systems (FMFIA Section 4 and FFMIA)

In conjunction with the Office of the Undersecretary of Defense (Comptroller) and service providers, the DON continues to assess relevant financial system security controls. These include security controls applied to systems during the Risk Management Framework (RMF) /Financial Management (FM) Overlay process to operate within the USN Information Technology (IT) environment and to ensure compliance with the OMB A-123, FMFIA, and FFMIA, Financial Improvement and Audit Remediation guidance, and NIST 800-53 Rev 4.

Based on the results of the assessment, the DON cannot provide reasonable assurance controls were operating effectively due to the three ICOFS MWs identified below as of September 30, 2020. The ICOFS MWs are assigned to the DASN (Financial Systems) and the USMC and have a similar remediation and validation process as ICOFR MWs.

Uncorrected ICOFS Material Weaknesses

Internal Control Reporting Category	Title of Material Weakness	First Year Reported	Targeted Correction Date
Interface Controls	Information Systems Interfaces	FY 2016	Q3 FY 2022
Multiple	Information Systems Configuration	FY 2015	Q2 FY 2021
Multiple	Information Systems Access Controls/ Segregation of Duties (SOD)	FY 2014	Q4 FY 2024

During the FY 2020 reporting period, the DON made considerable progress toward improving ICOFS. Effective October 1, 2019 the DON established the Office of the Chief of Information Officer (OCIO) to support efforts in modernizing many of the DON's business systems that are integral to supporting information management. The OCIO initiatives are integrated into the DON's effort to improve its financial management systems. Significant accomplishments for FY 2020 include:

Information Systems Interfaces:

- Developed Interface Memorandum of Agreement (MOA) and Interface Control Agreement templates to outline the controls and procedures that should be documented in accordance with the DON CIO & FM&C Enterprise IT Control Standards. The MOA and ICA templates are used by DON system owners to identify gaps and update their documentation.
- Implemented requirements for managing complete and accurate population of interfaces, edit checks & validations, and error handling/reconciliation for greater efficiency and process enforcement.
- Continued developing an automated solutions strategy leveraging Application Programming Interfaces to manage interfaces within Navy ERP and SABRS which will be implemented in FY 2021.

Access Controls and Segregation of Duties:

- Continued to assess, remediate, and mitigate cross-application SOD conflicts while developing the Identity and Access Management (IdAM) prototype integration with Navy ERP, which is expected to be completed in FY 2021.
- Continued developing the Access Violation Management (AVM) Tool that will be integrated with the Command Financial Management System (CFMS) and SABRS. The AVM Tool is planned for SOD conflict analysis, as well as continuously monitoring SOD conflicts that occur through transactional data.
- Deployed an initiative to assess privileged user controls across key financially relevant systems that have not been reviewed either externally or internally. The strategy will assess the identification, documentation, implementation and monitoring of access controls for these key systems. DON CIO will work with the systems in remediating issues identified to strengthen IT control.

Biennial Review Fees

The Chief Financial Officers Act of 1990 and OMB Circular A-25, User Charges, requires each agency CFO to review, on a biennial basis, the fees, royalties, rents, and other charges imposed by the agency for services and items of value provided to specific recipients, beyond those received by the general public. The purpose of this review is to periodically adjust existing charges to 1) reflect unanticipated changes in costs or market values, and 2) to review all other agency programs to determine whether fees should be assessed for Government services or the use of Government goods or services. Based on our review, we identified adjustments for fees to achieve full-cost recovery.

Entity-Level Control Assessment

The DON has an established Entity-Level Control (ELC) evaluation process to assess the design of the DON's entity-level controls as outlined in the Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government ("Green Book") as well as determine how well policies, programs, and directives that support ELCs are socialized and implemented across the enterprise.

Building on the program's FY 2019 assessment, the DON enhanced its assessment process by requiring MAUs to submit key supporting documentation to evidence control implementation and further expanding the scope to include fraud-specific assessment questions. The additional fraud questions support the DON's focus on assessing fraud-risk mitigation controls and the DoD-required assertion regarding ELCs and fraud controls.

Of the 48 ELC GAO Green Book attributes, the FY 2020 assessment identified seven attributes that were not fully implemented, compared to 21 attributes in FY 2019. The assessment concluded that:

- Risk tolerances are not well-defined due to the DON's broad scope of business activities and objectives.
- Processes to identify risk throughout the entity to provide a basis for analyzing risk need to be standardized.
- Controls related to processes used to respond to identified fraud risks so that they are effectively mitigated need to be strengthened.
- Entity-wide control activities are not established for all key end-to-end business processes.

Fraud Assessment

The Fraud Reduction and Data Analytics Act (FRDAA) of 2015 (Public Law No. 114-186) was re-codified into the Payment Integrity Information Act (PIIA) of 2019 (Public Law No. 116-117) in Fiscal Year (FY) 2020. PIIA retained FRDAA language, which requires agencies to report on their progress in implementing financial and administrative controls in compliance with the Office of the Secretary of Defense (OSD) guidelines, the fraud risk principle in the Standards for Internal Control in the Government, and the OMB Circular A-123.

To meet regulatory requirements and appropriately manage fraud risks, the Department of the Navy (DON) established the Fraud Risk and Data Analytics (FRDA) Branch within the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) (ASN (FM&C)) to oversee the DON's fraud risk management (FRM) program and improve fraud prevention, detection and response. The FRM program continued to evolve in FY 2020 to better align with the Office of the Undersecretary of Defense, Comptroller (OUSD(C)) anti-fraud strategy framework released in July 2020. Additionally, to create a more holistic approach to FRM at the Department-level, the DON has embarked on greater collaboration between fraud response stakeholders, ASN (FM&C), the Naval Criminal Investigative Service (NCIS), and the Naval Inspector General (NAVINSGEN) to share fraud threat intelligence.

In FY 2020, the DON conducted its first comprehensive Fraud Risk Assessment (FRA). The assessment focused on eight high-priority fraud risk areas: large contracts, payroll, grants, beneficiary payments, travel and fleet cards, purchase cards,

asset safeguards, and information technology (IT) & security. Overall, fraud risks for these areas were assessed from low to moderate. For areas with high inherent fraud risk, the DON has implemented effective controls to reduce the risk to an acceptable level, including entity level controls (ELC), process level controls, monitoring controls and fraud response activities. Further, the results of the assessment were used to inform the development of the DON's first fraud risk profile including fraud risk priorities and mitigation plans for any identified unmitigated residual risks.

A positive outcome of the fraud assessment is attributable to leadership's commitments to the DON's core values and the importance of ethics including strong antifraud tone at the top. While the DON continues to evolve its FRM program to adequately prevent, detect, and respond to fraud, the DON has implemented the following leading practices, procedures, and strategies to curb fraud:

- The DON has undertaken an education campaign within the Manager's Internal Control Program (MICP) community hosting A-123 Program Boot Camp training events throughout the year. Discussion topics included types of fraud and factors to consider when conducting fraud risks assessment. Corruption and other illegal acts, asset misappropriation, and fraudulent financial and non-financial reporting are types of fraud that were discussed.[1] The three fraud risks factors, which are incentives/pressures, opportunities, and attitudes/rationalization, drive the existence of fraud and influence the DON's susceptibility to fraud, waste, abuse, and mismanagement.
- The Naval Audit Service (NAVAUDSVC) conducts performance and compliance audits of the DON's mission and business operations. These performance audits assess the risk of fraud occurring as outlined in the NAVAUDSVC Handbook, Fraud Risk Matrix, and the Fraud Risk Assessment Checklist.
- NAVINSGEN's Hotline and investigations division executes the Department of Defense Inspector General (DoD IG) Hotline program and investigates complaints or allegations of wrongdoing and misconduct that involve or give rise to fraud, waste, or mismanagement at the DON. NAVINSGEN promotes awareness of its hotlines and investigative resources through onboarding training.
- NCIS serves as the primary law enforcement body for the DON, responsible for investigating criminal fraud within the United States (U.S.) Navy and U.S. Marine Corps (USMC). Quarterly, NCIS analysts compile a Fraud Paper by querying the case management system to identify emerging fraud trends.
- The OGC, Acquisition Integrity Office (AIO) monitors and coordinates criminal, civil, administrative, and contractual remedies for cases of acquisition fraud.
- The Naval Supply Systems Command (NAVSUP) manages the DON's bank card transaction review program to monitor potential improper charges for purchase, travel, and fleet cards. Automated analytic tools managed by the issuing financial institutions will flag potentially fraudulent activity for DON management follow up.
- The USMC Inspector General Assistance and Hotline Division maintains the USMC Hotline and ensures allegations of fraud, waste, abuse, mismanagement, misconduct, and whistleblower reprisal are properly recorded and routed for action by the appropriate office or agency.
- The Acquisition Integrity Working Group, comprising representatives from NAVINSGEN, NCIS, NAVSUP, AIO, the Assistant Secretary of the Navy (Research, Development and Acquisition) (ASN (RD&A)), and ASN (FM&C), meets quarterly to discuss new and emerging trends in procurement fraud cases and audit results. The working group provides a venue to share best practices and strengthen coordination across the DON in the fight against fraud.
- The DON participates in a fraud data analytics pilot with the OUSD (C).

Based on the result of FRA, ELC assessment, and the aforementioned established programs and procedures, the DON is able to provide reasonable assurance, except for one Oversight and Monitoring MW that ELCs, including fraud controls, are operating effectively as of September 30, 2020.

[1] Fraud types covered by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

ANALYSIS OF FINANCIAL STATEMENTS AND STEWARDSHIP INFORMATION

The accompanying financial statements and related disclosures represent the enduring commitment to fiscal accountability and transparency. The DON has made progress toward improving the quality and timeliness of financial information. However, the DON is currently unable to implement all elements of U.S. generally accepted accounting principles (GAAP) and OMB A-136 due to limitations of financial and non-financial management processes and systems feeding into the financial statements. These limitations prevented the IPA from issuing an opinion on the FY 2020 USN GF and DON WCF financial statements.

For financial reporting purposes, the USN GF and DON WCF financial statements include financial information for appropriations that are administered by BSOs. The sections that follow provides financial conditions and results of operations for USN GF and DON WCF activities.

Coronavirus Response Funding

On March 11, 2020, the World Health Organization declared the outbreak of coronavirus disease 2019 (COVID-19) a pandemic. In response to societal and economic impacts of COVID-19, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law on March 27, 2020 by the President to assist with preventing the spread and mitigating negative impact of the pandemic on individuals; businesses; and federal, state, local, and tribal government operations. The provisions of the CARES Act (Public Law 116-136) provided $835.3 million to Navy in emergency supplemental funding to prevent, prepare for, and respond to the COVID-19 pandemic. In addition, USN GF received an additional $566.0 million via internal realignment of CARES Act funds transferred in. These funds were provided across Operations and Maintenance (O&M) - Navy and Reserve, Other Procurement, Military Personnel and Revolving Fund appropriation categories.

For the purposes of recording, tracking, and reporting the obligation of these funds, Navy uses the following cost categories to indicate the purpose for which CARES Act resources were obligated:

- **DoD Operations:** Obligated for increased operations and deployment schedules as well as costs to support social distancing, quarantine requirements, etc.
- **IT Equipment/Support:** Obligated to procure IT equipment and increased bandwidth to continue operations
- **Cleaning Contracts and Non-Medical Supplies/Equipment:** Obligated for increased cleaning contracts and biohazard mitigation (disinfectants, sanitizers, cleaning materials)
- **Non-Medical PPE:** Obligated to procure PPE for first responders, installations, and ships
- **Transactions with Non-appropriated Fund Instrumentalities (NAFIs):** Coronavirus-related reimbursable transactions with revenue-generating NAFIs

Due to system limitations, Navy does not currently report proprietary accounting transactions related to COVID-19 activity.

Master-at-Arms 1st Classmen take the temperatures of test participants during the Navy-wide E6 advancement examination. (U.S. Navy photo by Chief Mass Communication Specialist Joseph M. Buliavac)

MANAGEMENT'S DISCUSSION AND ANALYSIS NAVY | FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

Limitations of the Financial Statements

The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 USC 3515(b). Formats prescribed by OMB have been used as a guide to prepare the statements from the books and records of the entity. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. government.

USN GF

The USN GF supports overall naval operations. Enacted appropriations comprise the majority of the USN GF account structure, which includes six major appropriation groups:

- Operation and Maintenance
- Military Personnel
- Procurement
- Research, Development, Test, and Evaluation
- Family Housing
- Military Construction

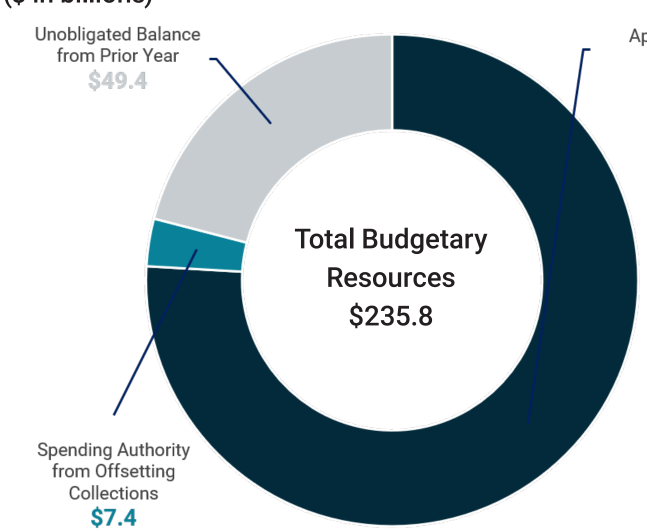
Enacted appropriations flow through OMB to the SECDEF and then to the SECNAV, where funds are allocated to administering offices and commands. The administering offices and commands obligate appropriations to fund operational expenses and capital investments and are required to exercise a system of effective control over financial operations.

Results of Operations

The Combined Statement of Budgetary Resources (SBR) presents Total Budgetary Resources of $235.8 billion that were available to the USN GF during FY 2020 and the status of those resources at the end of FY 2020. The enacted appropriations of $179.0 billion represent 75.9% of total budgetary resources. The Navy obligated $202.0 billion of the $235.8 billion total resources in FY 2020. The remaining $33.8 billion, or 14.3%, of available funding remained unobligated as of the end of FY 2020.

The Statement of Net Cost (SNC) presents Net Cost of Operations of $145.4 billion during FY 2020. Net Cost of Operations represents gross costs incurred by the USN GF less earned revenue. The SNC is presented with costs and earned revenues in accordance with OMB A-136 requirements.

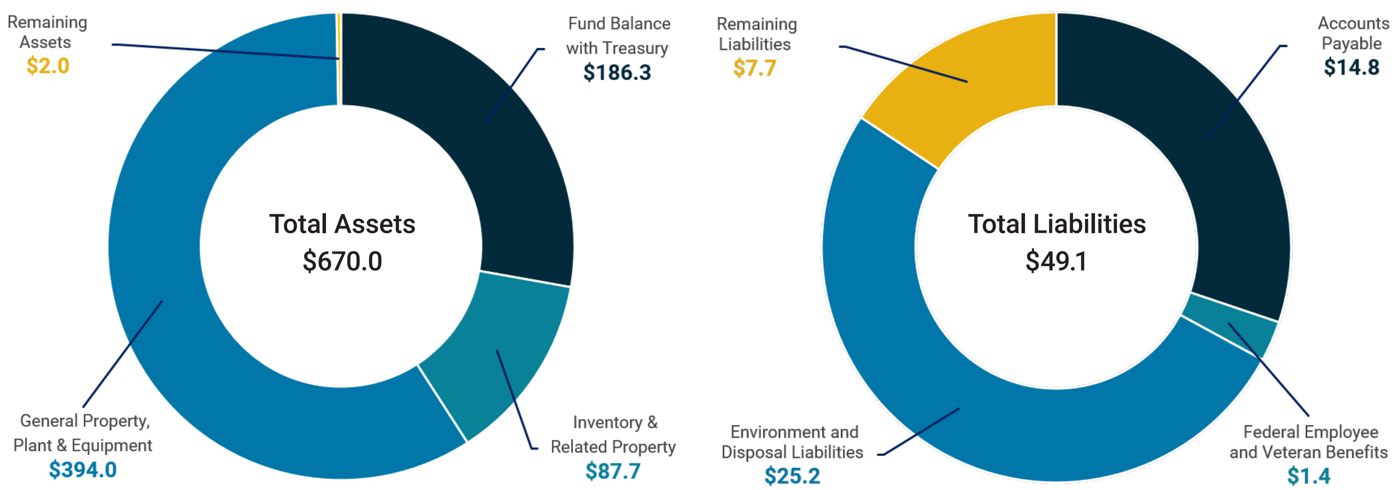
USN GF Sources of Funds ($ in billions)



Financial Position

The USN GF continued to report a positive Net Position on its Consolidated Balance Sheet, the difference between Total Assets of $670.0 billion and Total Liabilities of $49.1 billion. As of September 30, 2020, Net Position totaled $620.9 billion. The USN is a capital asset-intensive organization, with General Property, Plant, and Equipment (PP&E) representing 58.8% of Total Assets. These assets have significant associated environmental and disposal liabilities (E&DL) of $25.2 billion, or 51.3% of Total Liabilities.

USN GF Sources of Funds ($ in billions)



A Eurocopter AS332 Super Puma helicopter assigned to the fleet replenishment oiler USNS Pecos (T-AO 197) delivers cargo. (U.S. Navy photo by Mass Communication Specialist 3rd Class Nicholas V. Huynh/Released)

DON WCF

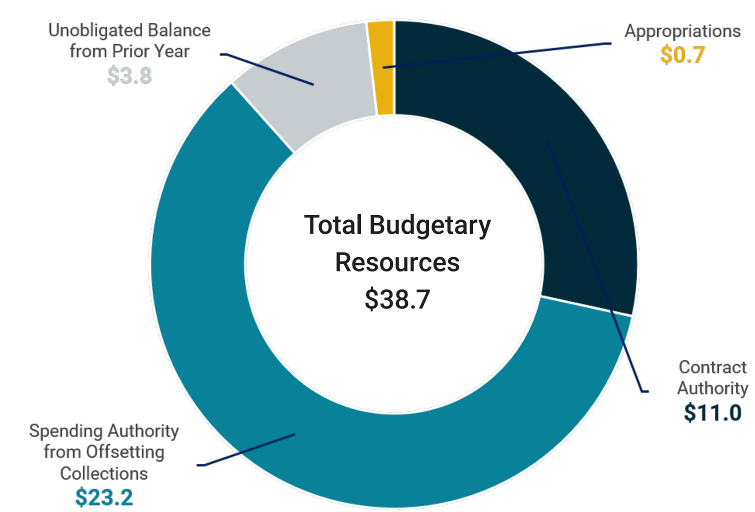
The DON WCF is a revolving fund established to meet the diverse requirements of the USN and USMC operating forces. Under the revolving fund concept, an appropriation or a transfer of funds finances initial DON WCF operations. The DON WCF then charges amounts necessary to recover the full cost of goods and services provided with the goal to break even over the long term. DON WCF business areas allow the DON to absorb risk in planning investment programs for acquisitions, maintenance, and supply. In FY 2020, DON WCF received appropriations related to COVID, no such funds were received in FY 2019. Of these appropriated funds, $475.0 million is related to Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R 748-240/ Public Law 116-136 DWCF) and $234.0 million is from the Consolidated Appropriations Act, 2020 (H R. 1158-69/ Public Law 116-93) which was enacted in December 2019.

Results of Operations

The SBR presents Total Budgetary Resources of $38.7 billion that were available to the DON WCF during FY 2020. DON WCF budget authority is comprised of Contract Authority and Spending Authority from Offsetting Collections of which the latter accounts for $23.2 billion or 59.9% of total budgetary resources.

The SNC presents net cost of operations of $2.3 billion during FY 2020. Net Cost of Operations represents gross costs incurred by DON WCF less Earned Revenue. Sources of Earned Revenue include DON, U.S. Army, and U.S. Air Force GF; Defense Working Capital Funds; other Navy and DoD appropriations; and non-DoD fund sources.

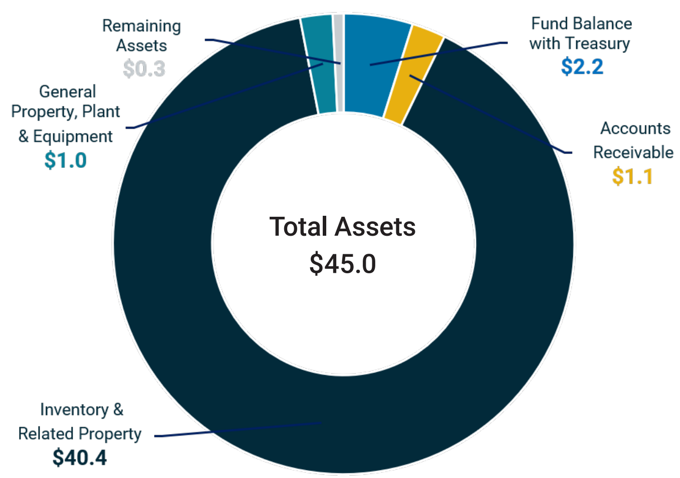
DON WCF Sources of Funds ($ in billions)



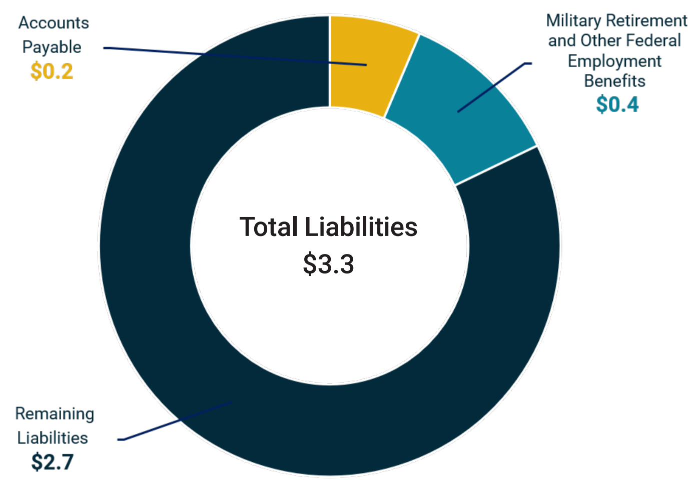
Financial Position

The DON WCF reported a positive Net Position on its Consolidated Balance Sheet. Net Position is the difference between Total Assets of $45.0 billion and Total Liabilities of $3.3 billion. As of September 30, 2020, Net Position totaled $41.7 billion.

DON WCF Total Assets ($ in billions)



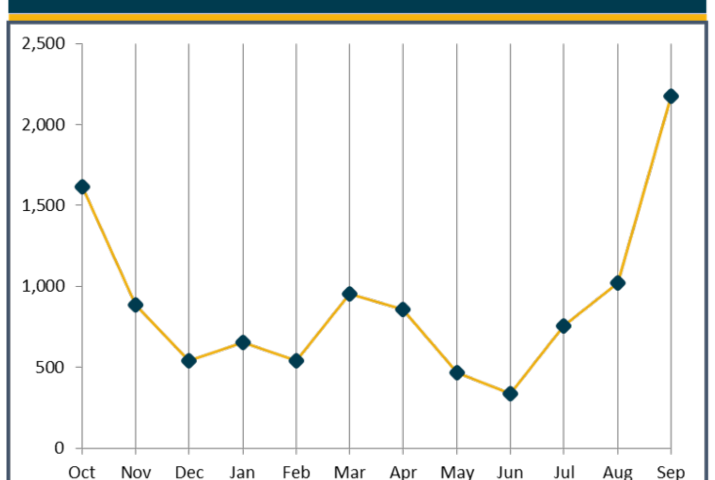
DON WCF Total Liabilities ($ in billions)



Cash Management

The DON WCF manages cash at the departmental level and must maintain a minimum cash balance necessary to meet operations, capital investments, and other justified requirements, as required by the DoD Financial Management Regulation (FMR). The DON WCF has established a high and low cash requirement based on business events and activities relevant to its operations. For the period ended September 30, 2020, the high cash requirement was $2.4 billion, and the low cash requirement was $1.3 billion.

MONTHLY DON WCF CASH BALANCES OCTOBER 1, 2019 TO SEPTEMBER 30, 2020 ($ in millions)



THIS PAGE INTENTIONALLY LEFT BLANK

Front to back; the expeditionary fast transport ship USNS Millinocket (T-EPF 3), the Sri Lanka navy vessel SLNS Samudura (P 621), the guided-missile destroyer USS Spruance (DDG 111), and the Sri Lanka navy warship SLNS Sayurala (P 623) transit the Indian Ocean performing formation maneuvers during the sea phase of the U.S. Navy's 25th annual Cooperation Afloat Readiness and Training (CARAT) exercise series with the Sri Lanka navy. (U.S. Navy photo by Mass Communication Specialist 1st Class Ryan D. McLearnon)

FINANCIAL SECTION

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

The Department of the Navy (DON) is advancing its goal of transforming business practices for greater performance and affordability. Fiscal year (FY) 2020 marked the third year of full financial statement audits of the DON's three reporting entities: Navy General Fund, Marine Corps General Fund, and the DON Working Capital Fund. These financial statement audits touch every part of our organizations' operations. We have made significant progress toward achieving a positive opinion for Marine Corps General Fund. While the Navy General Fund and DON Working Capital Fund received disclaimers of opinion in FY 2020, we continue to transform the way we operate and are executing against a clear plan for success.

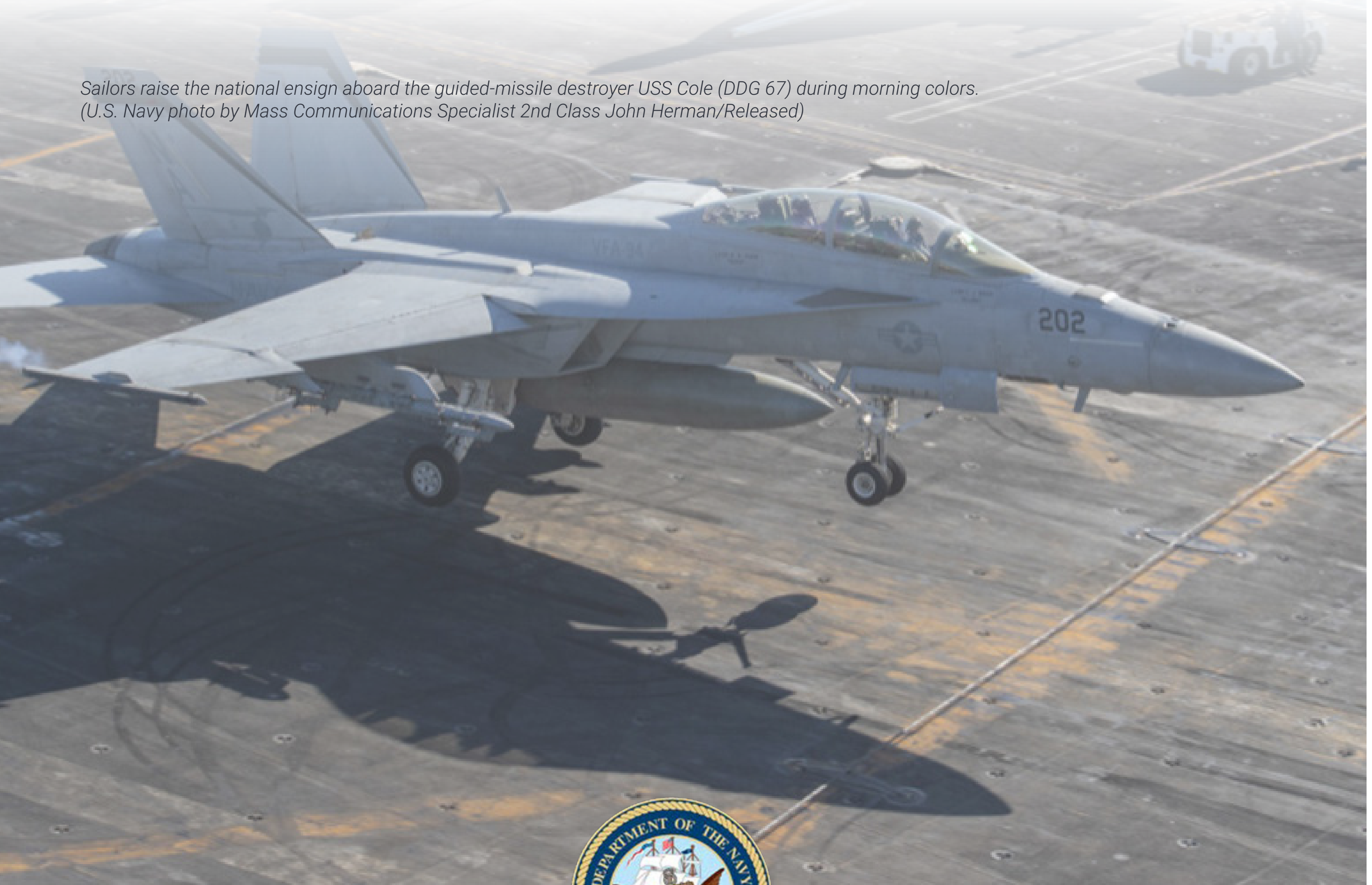
Each year, we expand the breadth and depth of audit testing, helping us find and correct inefficiencies and identify areas that need improvement. Efforts to strengthen business processes, systems, and reporting of financial information resulted in eliminating or downgrading several major deficiencies in how the DON operates. Additionally, improvements to systems, operational controls, and data transparency give decision-makers better insight into resources and asset accountability, which enhances readiness and accelerates DON reform efforts. As a result, we are demonstrating sound stewardship to the American people and have begun to realize substantial financial and operational benefits. This year we:

- Embarked on a first-of-its-kind Navy Material Accountability Campaign (NMAC), a sweeping effort across the enterprise to understand what materiel Navy has on hand, and to locate untracked and excess materiel. As a result of NMAC, in FY20 Navy commands identified more than $442 million in materiel that previously was not globally visible to the organization – these assets are now being redeployed in support of our most critical needs. When combined with pilot programs dating back to FY18, the Navy's inventory efforts have identified $3.4 billion in materiel to date that is now retained, visible, tracked and made available for potential fleet use or disposal. NMAC has already bolstered Fleet readiness and improved accountability of our equipment and operating materiel.
- Continued to migrate all unclassified financial activity to DON ERP, a key element in Navy's strategy to obtain a clean audit opinion and increase the Service's readiness and accountability. During FY20, the DON transitioned three working capital fund activities into Navy ERP. These accomplishments validate the DON's strategy to eliminate stove-piped systems and improve the speed and transparency of data across the enterprise.
- Downgraded two material weaknesses (MWs) demonstrating progress toward an audit opinion. These MWs included Contingent Legal Liabilities and Contract Authority. We began FY20 with the ambitious goal of closing these MWs, developed a plan for success, and executed with unrelenting focus.

As we move forward, we will continue to concentrate resources on remediating findings in areas with the greatest impact on naval enterprise readiness and operational excellence, so our sailors always maintain a superior advantage. Our Financial Management Transformation initiatives align and prioritize DON remediation efforts with the National Defense Strategy. The DON Audit Roadmap is our tactical framework that identifies key milestones for each priority area, targets resources for maximum impact, helps manage risk, and delineates a clear path to a clean opinion. Real-time data analytics give us the information we need to accurately assess whether our remediation efforts are driving the expected outcomes and arms us with the information we need to successfully execute our plan. The DON's strong governance system gives leaders oversight into everything we do to hold ourselves accountable.

The men and women of the Navy and Marine Corps benefit greatly from these audits, and we are capitalizing on findings to make operational and process improvements necessary to improve our warfighting capability and readiness. Our commitment to achieving a clean audit opinion and demonstrating prudent use of the American taxpayer funds entrusted to us does not waver.

Alaleh A. Jenkins
Performing the Duties of the Assistant Secretary of the Navy
(Financial Management and Comptroller)
December 11, 2020



Sailors raise the national ensign aboard the guided-missile destroyer USS Cole (DDG 67) during morning colors. (U.S. Navy photo by Mass Communications Specialist 2nd Class John Herman/Released)

UNITED STATES NAVY GENERAL FUND

PRINCIPAL STATEMENTS

The FY 2020 USN GF principal statements and related notes are presented in the format prescribed by OMB A-136, except as otherwise disclosed. The statements and related notes summarize financial information for individual funds and accounts within the USN GF for the fiscal year ended September 30, 2020 and are not presented on a comparative basis.

The following section is comprised of the USN GF principal statements and related notes:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources
- Related Notes

US NAVY GENERAL FUND
Consolidated Balance Sheet
As of September 30, 2020

($ in thousands)	Unaudited 2020
ASSETS (Note 2):	
Intragovernmental:	
Fund Balance with Treasury (Note 3)	$ 186,281,120
Accounts Receivable (Note 5)	253,390
Other (Note 9)	1,107,488
Total Intragovernmental	**187,641,998**
With the Public:	
Cash and Other Monetary Assets (Note 4)	97,312
Accounts Receivable, Net (Note 5)	45,339
Inventory and Related Property, Net (Note 6)	87,658,321
General Property, Plant and Equipment, Net (Note 7)	394,036,341
Other (Note 9)	522,747
Total with the Public	**482,360,060**
TOTAL ASSETS	**$ 670,002,058**
STEWARDSHIP PP&E (Note 8)	
LIABILITIES (Note 10)	
Intragovernmental:	
Accounts Payable	$1,647,766
Other (Note 13 & 15)	644,799
Total Intragovernmental	**2,292,565**
With the Public:	
Accounts Payable	13,209,497
Federal Employee and Veteran Benefits (Note 11)	1,362,933
Environmental and Disposal Liabilities (Note 12)	25,224,975
Accrued Unfunded Annual Leave	3,036,558
Other (Note 13 & 15)	4,008,136
Total with the Public	**46,842,099**
TOTAL LIABILITIES	**$ 49,134,664**
COMMITMENTS AND CONTINGENCIES (Note 15)	
NET POSITION:	
Cumulative Results of Operations	$58,182
Total Net Position - Funds from Dedicated Collections (Note 16)	58,182
Unexpended Appropriations - All Other Funds	169,289,997
Cumulative Results of Operations	451,519,215
Total Net Position - Funds other than those from Dedicated Collections	620,809,212
Total Net Position	**$ 620,867,394**
TOTAL LIABILITIES AND NET POSITION	**$ 670,002,058**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND
Consolidated Statement of Net Cost
For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020
GROSS PROGRAM COSTS (Note 17)	
Gross Costs:	
Military Personnel	$ 36,080,269
Operations, Readiness & Support	63,440,812
Procurement	39,278,935
Research, Development, Test & Evaluation	19,392,927
Family Housing & Military Construction	29,898
Less: Earned Revenue	(3,510,564)
NET COST OF OPERATIONS	**$ 154,712,277**

The accompanying notes are an integral part of these statements.

Boatswain's Mate 3rd Class picks up a line on a fuel sponson aboard of the Nimitz-class aircraft carrier USS Harry S. Truman. (U.S. Navy photo by Mass Communication Specialist Seaman Brandon M. Fryman/Released)

US NAVY GENERAL FUND
Consolidated Statement of Changes in Net Position
For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020			
	Funds From Dedicated Collections (Consolidated Totals) (Note 16)	**All Other Funds** (Consolidated Totals)	**Eliminations**	**Consolidated Total**
UNEXPENDED APPROPRIATIONS:				
Beginning Balances	$ —	$ 157,886,763	$ —	$ 157,886,763
BUDGETARY FINANCING SOURCES:				
Appropriations Received	—	180,170,254	—	180,170,254
Appropriations Transferred in/out	—	(379,404)	—	(379,404)
Other Adjustments	—	(2,802,292)	—	(2,802,292)
Appropriations Used	—	(165,585,324)	—	(165,585,324)
TOTAL BUDGETARY FINANCING SOURCES	—	$ 11,403,234	—	$ 11,403,234
TOTAL UNEXPENDED APPROPRIATIONS	**$ —**	**$ 169,289,997**	**$ —**	**$ 169,289,997**
CUMULATIVE RESULTS FROM OPERATIONS:				
Beginning Balances	54,553	438,093,352	—	438,147,905
Changes in Accounting Principles	—	(490,772)	—	(490,772)
BEGINNING BALANCES, AS ADJUSTED	54,553	437,602,580	—	437,657,133
BUDGETARY FINANCING SOURCES:				
Other Adjustments	—	5,461	—	5,461
Appropriations Used	—	165,585,324	—	165,585,324
Non-exchange Revenue	99	—	—	99
Donations and Forfeitures of Cash and Cash Equivalents	29,125	—	—	29,125
Transfers-In/Out Without Reimbursement	—	(5,128)	(5,128)	—
OTHER FINANCING SOURCES (NON-EXCHANGE):				
Transfers In/Out Without Reimbursement	—	3,313,368	5,128	3,308,240
Imputed Financing	—	680,739	—	680,739
Other	—	(976,447)	—	(976,447)
TOTAL FINANCING SOURCES	$ 29,224	$ 168,603,317	$ —	$ 168,632,541
Net Cost of Operations (Note 17)	25,595	154,686,682	—	154,712,277
NET CHANGE	**3,629**	**13,916,635**	**—**	**13,920,264**
CUMULATIVE RESULTS OF OPERATIONS	**$ 58,182**	**$ 451,519,215**	**$ —**	**$ 451,577,397**
NET POSITION	**$ 58,182**	**$ 620,809,212**	**$ —**	**$ 620,867,394**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND
Combined Statement of Budgetary Resources
For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020
BUDGETARY RESOURCES:	
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$ 49,417,180
Appropriations (discretionary and mandatory)	178,982,084
Spending Authority from Offsetting Collections (discretionary and mandatory)	7,368,084
Total Budgetary Resources	**$ 235,767,348**
STATUS OF BUDGETARY RESOURCES:	
New Obligations and Upward Adjustments (total)	$ 202,024,879
Unobligated Balance, End of Year:	
Apportioned, Unexpired Accounts	30,414,342
Exempt from Apportionment, Unexpired Accounts	45,166
Unapportioned, Unexpired Accounts	178,123
Unexpired Unobligated Balance, End of Year	30,637,631
Expired Unobligated Balance, End of Year	3,104,838
Unobligated Balance, End of Year (total)	33,742,469
Total Budgetary Resources	**$ 235,767,348**
OUTLAYS, NET, and DISBURSEMENTS, NET	
Outlays, Net (total) (discretionary and mandatory)	165,358,444
Distributed Offsetting Receipts (-)	(47,561)
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$ 165,310,883**

The accompanying notes are an integral part of these statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.A. Reporting Entity

The DON is a complex organizational entity comprised both of subordinate organizations, as well as other entities, which are administratively aligned to the USN mission, but funding for those operations is provided by external reporting entities.

For financial reporting purposes, the DON is organized into two reporting entities: the USN GF and the DON WCF. The DON WCF includes financial information for both the Navy and the Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures. This section of the AFR specifically applies to the USN GF, as a result, it does not disclose information related to the DON WCF or the USMC.

Refer to the MD&A Section – "Mission and Organization" for additional information.

The USN GF has relationships with Non-Appropriated Funds Instrumentalities (NAFIs) and Federally Funded Research and Development Centers (FFRDCs) that meet certain control elements regarding risk of loss or expectation of benefits. However, the USN GF does not meet enough control elements to consider them consolidating entities.

Refer to Note 22, "Disclosure Entities and Related Parties" for additional information.

1.B. Basis of Presentation and Accounting

These non-comparative financial statements reflect both proprietary and budgetary accounting transactions and are comprised of the consolidated balance sheet, consolidated statement of net cost, consolidated statement of changes in net position, and the combined statement of budgetary resources of the USN GF. USN GF does not show comparative financial statements because financial statement line item values are changing due to remediation efforts and any comparison could be misleading to the reader. These financial statements have been prepared from the accounting records of the USN GF in accordance with, to the extent possible, U.S. GAAP promulgated by the Federal Accounting Standards Advisory Board (FASAB), OMB Circular A-136, Financial Reporting Requirements, Revised (August 2020) and the DoD, *Financial Management Regulation (FMR).*

Accounting standards require all reporting entities to disclose that certain presentations and disclosures can be modified, if needed, to prevent the disclosure of classified information.

The USN GF is unable to implement all elements of GAAP, OMB A-136, and FFMIA due to limitations of financial and non-financial management processes and systems that support the financial statements. These limitations are noted throughout the AFR as applicable.

The USN GF derives reported values and information for major asset and liability categories from both financial and non-financial systems. The non-financial systems were designed primarily to support reporting requirements for maintaining accountability over assets rather than preparing financial statements in accordance with GAAP. The USN GF continues to implement process and system improvements to address these limitations.

The financial statements are compiled from the underlying financial data and trial balances of the USN GF's general ledger accounting systems. The underlying data is largely derived from budgetary transactions (e.g., obligations, disbursements, and collections), non-financial feeder systems, and accruals made for major items (e.g., payroll expenses, accounts payable, Federal Employees' Compensation Act [FECA] Liabilities, and E&DL). Some of the general ledger trial balances may reflect abnormal balances resulting largely from faulty business and system processes and may not be evident within the financial statements. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated/combined level.

The USN GF is not in full compliance with the following authoritative accounting guidance to include Statement of Federal Financial Accounting Standards (SFFAS), Treasury Financial Manual (TFM) and GMRA:

- SFFAS 1, "Statement of Federal Financial Accounting Standards, "Accounting for Selected Assets and Liabilities"
- SFFAS 3, "Accounting for Inventory and Related Property"
- SFFAS 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government"
- SFFAS 5, "Accounting for Liabilities of the Federal Government"
- SFFAS 6, "Accounting for Property, Plant, and Equipment"
- SFFAS 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting"
- SFFAS 10, "Accounting for Internal Use Software"
- SFFAS 15, "Management's Discussions and Analysis"
- SFFAS 21, "Reporting of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources"
- SFFAS 29, "Heritage Assets and Stewardship Land"
- SFFAS 44, "Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use"
- SFFAS 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials"
- SFFAS 50, "Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35"
- SFFAS 53, "Budget and Accrual Reconciliation"
- SFFAS 55, "Amending Inter-entity Cost Provisions"
- TFM
- FFMIA of 1996
- GMRA of 1994

Certain disclosures related to the DoD Component Reporting Entity (CRE) are not presented, including those required by the Improper Payments Information Act (IPIA) of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010 and the Improper Payments Elimination and Recovery Improvement Act of 2012; Section 3 of the OMB Memorandum M-12-12, "Promoting Efficient Spending to Support Agency Operations"; and the OMB Management Procedures Memorandum 2016-04, "Grants Oversight and New Efficiency (GONE) Act Reporting of Unclosed Grant and Cooperative Agreement Awards for Which the Period of Performance Has Expired More Than Two Years." These disclosures are presented in the DoD AFR on behalf of the USN.

1.C. Appropriations and Funds

The USN GF receives appropriated and non-appropriated funds to include general, revolving, trust, special deposit funds, and funds from dedicated collections. The USN GF uses these funds to execute its missions and subsequently report resource usage.

- **General Funds** are used for financial transactions funded by congressional appropriations, including personnel, operation and maintenance, research and development, procurement, family housing, and military construction.
- **Revolving Fund** accounts are funds authorized by specific provisions of law, financed by a corpus through an appropriation or a transfer, to perform a continuing cycle of operations through the sales of goods and services without fiscal year limitations. The NDSF is the USN GF's only revolving fund. This unique fund receives annual appropriations expiring after five years and the revenues generated from the sales of goods and services do not expire.
- **Trust Fund** accounts contain receipts and expenditures of funds held in trust by the government for specific purposes or for carrying out or programs in accordance with the terms of the USN GF, trust agreement, or statute.
- **Special Fund** accounts are used to record receipts reserved for a specific purpose, such as funds from dedicated collections.
- **Deposit Fund** accounts are used to record monies held temporarily, where the USN GF is acting as an agent or a custodian for funds awaiting distribution to the appropriate government or public entity. These deposit funds are not USN GF funds, and as such, are not available for the USN GF's operations.
- **Funds from Dedicated Collections** are financed by specifically identified revenues, often supplemented by other financing sources that are originally provided to the federal government by a non-federal source, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the federal government's general revenues.

Refer to Note 16, "Funds from Dedicated Collections" for additional information.

1.D. Use of Estimates

Preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. As a result, actual results may differ from those estimates. Significant estimates and assumptions include, but are not limited to, plant replacement values for real property, general equipment including depreciation, OM&S (e.g. held for repair), environmental liabilities, allowance for doubtful accounts (AFDA), payroll expenses, Accounts Payable, bulk obligations, Contingent Legal Liabilities, and unbilled revenue.

Significant estimates are not reasonable and supportable with the exception of Contingent Legal Liabilities.

1.E. Revenues and Other Financing Sources

The USN GF recognizes revenue generated by the sales of goods and/or services and the costs incurred to provide those goods and services to other DoD entities, other federal agencies, and the public. Full-cost pricing is the USN GF's standard policy for services provided. The USN GF recognizes revenue when earned within the constraints of its current system capabilities. In many instances, revenue is recognized when bills are issued and not when revenue is earned.

The USN GF does not include non-monetary support provided by U.S. allies for common defense and mutual security in the amounts reported in the SNC and Note 20, "Reconciliation of Net Cost to Net Outlays." The U.S. has cost-sharing agreements with countries that have a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in port.

The USN GF records donations in trust funds and special funds as non-exchange revenue. The USN GF recognizes non-exchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not receive value in return. Non-exchange revenue is not considered to reduce the cost of USN GF operations and is therefore reported in the SCNP as a financing source. In certain instances, the USN GF's operating costs are paid out of funds appropriated to other federal entities. For example, by law, certain costs of retirement programs are paid by the Office of Personnel Management (OPM) and certain legal judgments against the USN GF are paid from the Judgment Fund maintained by Bureau of Fiscal Service (Fiscal Service), Treasury. When costs are identifiable to the USN GF, directly attributable to the USN GF's operations, and paid by other agencies, the USN GF recognizes these amounts as imputed costs within the SNC and as an imputed financing source on the SCNP.

1.F. Recognition of Expenses

The USN GF utilizes a combination of financial transactions within its accounting system and data calls to obtain and record financial amounts, including some expenses, which results in the untimely recording of some expense activity. Current financial and non- financial feeder systems were not designed to collect and record financial information on a full accrual accounting basis.

For OM&S, operating expenses are not always recognized when the items are consumed. Efforts are underway to transition to the consumption method to properly recognize expenses. Due to system limitations, the use of OM&S in constructing capital and other long-term assets may be recognized as operating expenses. The USN GF is implementing process and system improvements to correct these limitations.

1.G. Accounting for Intragovernmental Activities

The USN GF cannot accurately identify intragovernmental transactions (e.g., revenues, expenses, accounts receivable, accounts payable, and non-expenditure transfers) by customer to properly eliminate intra-entity and trading partner activity and balances from the financial statements. The USN GF's systems do not track buyer and seller data at the transaction level; thereby increasing the risk that all eliminating entries have not been recorded. Generally, seller entities within the USN GF provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with the USN GF's seller-side balances and are then eliminated. The USN GF continues to implement process and system improvements to address these limitations that will enable the USN GF to correctly report, reconcile, and eliminate intragovernmental balances.

The USN GF can reconcile balances pertaining to investments in federal securities, borrowings from the Treasury and the Federal Financing Bank, FECA transactions with the Department of Labor (DOL), and benefit program transactions with the OPM.

1.H. Fund Balance with Treasury

The USN GF's monetary resources are maintained in Treasury accounts. The USN GF generally does not maintain cash in commercial bank accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), USN GF, other military departments, and Department of State (State) financial service centers process the majority of the USN GF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports for the Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits. The disbursing station monthly reports are consolidated at the disbursing office level for financial reporting purposes. In Fiscal Year 2020, the USN in partnership with DFAS, implemented Treasury Direct Disbursing (TDD) for a portion of vendor payments. TDD is the process of utilizing Treasury as a service provider to process disbursements, thereby eliminating the requirements for disbursing stations to prepare monthly reports for Treasury in order to report fund balance activity. Implementation of TDD resulted in USN having a blended disbursing environment, where both Non-Treasury Disbursed and TDD processes support the generation of disbursement transactions affecting fund balance.

In addition, DFAS and the U.S. Army Corps of Engineers (USACE) Finance Center submit reports to the Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The Treasury records these transactions to the applicable FBwT account. On a monthly basis, the USN GF's FBwT is reviewed and adjusted at the Department level within the DoD's Defense Departmental Reporting System-Budgetary (DDRS-B). FBwT variances identified after the GL systems have closed each month are addressed through adjustments entered during the financial reporting process in DDRS to record undistributed disbursements and collections. These adjustments, if required, help to ensure the USN GF's financial statements agree with the Treasury accounts.

Refer to Note 3, "Fund Balance with Treasury," for additional information.

1.I. Cash and Other Monetary Assets

Cash is the total of cash resources under the control of USN GF including coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and non-purchased foreign currencies held in foreign currency fund accounts. Foreign currency is valued using the U.S. Treasury prevailing rate of exchange.

Cash and foreign currency are classified as "nonentity" and is restricted. Amounts reported consist primarily of cash and foreign currency held by disbursing officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

The USN GF conducts a significant portion of its operations overseas with business conducted in foreign currency. The primary source of the amounts is reported on the Disbursing Officers Statement of Accountability. The USN GF reports gains and losses from foreign currency transactions in the Gains and Deficiencies on Exchange Transactions account for the following general fund appropriations: (1) operations and maintenance; (2) military personnel; (3) military construction; (4) family housing operation and maintenance; and (5) family housing construction. The USN GF accounts for foreign currency fluctuations related to other appropriations by adjusting the original obligation amount at the time of payment. The USN GF does not separately identify currency fluctuation transactions.

1.J. Accounts Receivable

Accounts Receivable, inclusive of claims receivable and refunds receivable, consists of amounts owed to the USN GF by other federal agencies and the public. The USN GF estimates losses due to uncollectible non-federal amounts based on Accounts Receivable debt type depending on delinquency age. The USN GF uses non-intragovernmental data to age receivables based on an analysis of field-level accounts receivable detail reports to determine collectability of each aging category that is less than 150 days delinquent. Additionally, the USN GF recognizes an allowance for all non-intragovernmental accounts receivable that are 150 days delinquent.

Gross receivables must be reduced to net realizable value by an allowance for doubtful accounts. FASAB Technical Bulletin 2020-1 clarifies that SFFAS 1 standards, including recognition of losses, apply to receivables from federal and non-federal entities. Currently, the USN GF/DON WCF is not fully compliant with the aforementioned authoritative guidance. The USN GF/DON WCF does not calculate an intragovernmental receivables loss allowance.

Refer to Note 5, "Accounts Receivable, Net" for additional information.

1.K. Inventory and Related Property

All inventory held for sale is funded and reported under the DON WCF financial statements. The USN GF does not maintain inventory for sale. USN GF Related Property is comprised of OM&S, including the following OM&S segments: Ordnance (e.g., ammunition, conventional missiles and torpedoes), Trident missiles (submarine launched nuclear capable ballistic missiles), centrally managed Uninstalled Aircraft Engines (UAE), OM&S Remainder (OM&S-R) assets (all non-ordnance materials, uninstalled modification kits, spares and repair parts for major end items (e.g., ships, aircraft, tanks), clothing, textiles, and petroleum products), and OM&S In Development (OID) (e.g. all direct and indirect costs, including direct labor, direct material, direct purchased services, overhead or project costs incurred to bring the OM&S to a form and condition suitable for its intended use).

Due to long standing business processes and financial system deficiencies, the USN GF is unable to make an unreserved assertion for OM&S opening balances. The USN GF accounts for OM&S using a combination of the Consumption and Purchase Method of accounting. The Consumption Method of accounting is the Navy's standard method except where an exemption to use the Purchase method has been granted.

The USN GF values OM&S assets held for use, held in reserve for future use, and OM&S in development using multiple valuation methods: moving average cost (MAC), historical cost, and latest acquisition cost (LAC). Excess, obsolete, and unserviceable (EOU) OM&S is valued using a net realizable value (NRV) of zero pending development of an effective means of valuing such material. Adjustments for repair costs under the Direct Method are made only to UAE; valuation adjustments pertaining to repair cost are not currently calculated for Ordnance and Remainder. OM&S materials held for repair are reported under held in reserve for future use.

The LAC method is used for OM&S accounted for in legacy logistics systems that were designed specifically for material management rather than for accounting purposes. The USN GF is in the process of resolving these weaknesses and transitioning to a MAC valuation methodology. The valuation methods for OM&S cannot be supported.

Refer to Note 6, "Inventory and Related Property, Net" for additional information.

1.L. Investments and Related Interest

The USN GF reports investments in Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts are amortized over the term of the investments using the effective interest rate method, or another method obtaining similar results. The USN GF's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, a provision is not made for unrealized gains or losses on these securities. The USN GF invests in non-marketable and market-based Treasury securities, issued to federal agencies by the Treasury's Bureau of the Fiscal Service. These securities are not traded on any financial exchange but are priced consistently with publicly traded Treasury securities. Accrued interest represents the amount of interest accrued on investment securities, but not received as of the date of the financial statements.

Refer to Note 9, "Other Assets" for additional information.

1.M. General Property, Plant, and Equipment

Due to long standing business process and financial system deficiencies, the USN GF is unable to make an unreserved assertion for GPP&E opening balances. The USN GF continues to implement sustainable go-forward GAAP-compliant processes.

Currently, the USN GF uses actual costs for valuing aircraft placed in service after FY 2017 and vessels placed in service after FY 2020. To establish a baseline, the USN GF accumulated information relating to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition, and disposal information.

- **Ships, submarines, aircraft, and satellites:** The USN GF procures and owns all the DON aircraft, to include aircraft that are operated by USMC. USN GF valued baseline assets by establishing deemed costs using appropriations for ships and submarines, budgetary estimates for aircraft, and contracts supported by invoices and cost of similar assets for ships, submarines, aircraft, and satellites.
- **General equipment – remainder:** The USN GF values remaining assets based on historical cost or the cost of select similar assets at the time of acquisition. The Navy has not fully implemented SFFAS 50 with respect to the general equipment – remainder category.
- **Equipment held by contractors:** The USN GF provides government property to contractors to complete contract work. The USN GF owns such property and either provides it to the contractor or it is purchased directly by the contractor on behalf of the government. The Federal Acquisition Regulation (FAR) requires the USN GF to maintain information on all property furnished to contractors in the USN GF property systems. The USN GF reports such property when the value of contractor- procured General Equipment meets or exceeds the USN GF capitalization threshold (which applies to both assets and capital improvements) and is reported on the Balance Sheet. The USN GF is not in compliance with the FAR or federal accounting standards and is in the process of implementing business process and system improvements to do so.

- **Land and land rights:** The USN GF has elected to exclude its land and land rights from the GPP&E opening balance. Future land and land rights will be expensed. Acreage for land will be disclosed in Note 7, "General Property, Plant and Equipment.
- **Real property:** The USN GF values its buildings, structures, and linear structures (including utilities) at Plant Replacement Valuation (PRV). PRV represents an estimate of the replacement cost in current year dollars to design and construct a facility to replace an existing facility at the same location.
- **Construction-in-Progress:** Construction in Progress (CIP) reflects the resources expended to construct PP&E that have not been placed in service as of the end of the fiscal year.

The USN GF uses several capitalization thresholds for its GPP&E dependent upon date of asset capitalization. For all general fund assets acquired or developed after June 30, 2013, the USN GF uses a $1.0 million threshold for general equipment. In FY 2020, Navy changed the capitalization threshold for real property, which only uses one capitalization threshold, from $250 thousand to $1.0 million. Due to business process and system limitations, the USN GF does not currently report accurate values related to CIP and internal use software (IUS).

Partial asset impairment is not a common occurrence in the USN GF, as assets are either repaired to restore lost utility or removed from service. However, the USN GF will recognize impairments for classes of assets or locations in the case of major events, (e.g., natural disasters) or if the impairment affects an entire class of assets.

The USN GF capitalizes GPP&E at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The USN GF capitalizes improvements to existing GPP&E if the improvement equals or exceeds the USN GF's capitalization threshold, extends the useful life of the underlying asset, or increases asset size, efficiency, or capacity. The USN GF depreciates all GPP&E, other than land, on a straight-line basis.

Refer to Note 7, "General Property, Plant and Equipment, Net" for additional information.

1.N. Stewardship Property, Plant, and Equipment

The USN GF has become a large-scale owner of historic buildings, structures, districts, historical artifacts, art, ships, sunken ships, aircraft, archeological sites, installation and stewardship land, and other cultural resources. The USN GF does not capture information relative to Heritage Assets separately and distinctly from normal operations due to business process and system limitations.

The USN GF is unable to separately and distinctly identify the cost of acquiring, constructing, improving, reconstructing, or renovating heritage assets from normal operations.

Refer to Note 8, "Stewardship PP&E" for additional information.

1.O. Advances and Prepayment

When making payments in advance of the receipt of goods and services is permitted by law, legislative action, or Presidential authorization, the USN GF's policy is to record advances or prepayments as an asset on the Balance Sheet. Upon receipt of the related goods and services, the USN GF's policy is to reduce the advances and prepayments and properly classify the assets. Advances and prepayments received are recorded as liabilities.

1.P. Leases

The USN GF classifies its leases as either operating or capital. Payments for operating leases are expensed over the lease term as they become payable. Currently, the USN GF does not classify any leases as capital leases.

Refer to Note 14, "Leases" for additional information.

1.Q. Other Assets

Other assets include military and civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the USN GF's Balance Sheet.

- **Advances** are cash outlays made by the USN GF to its employees, contractors, or others to cover part or all the recipients' anticipated expenses.
- **Military pay advances** are advance payments authorized for purposes intended to ease hardships imposed by the lack of regular payments when a military member is mobilized, ordered to duty at distant stations, or deployed aboard ships for more than 30 days. Pay advances may be repaid over 24 months. For pay advances extending into future fiscal years, the USN GF advances future fiscal year pay using fiscal year appropriations current at the time of the advance. In subsequent fiscal years, USN GF transfers appropriations to the prior fiscal year appropriation in the amount of any unliquidated advance payments that remain at the end of such prior fiscal year as required by 37 USC 1006.
- **Civilian pay advances** are payments advanced to full-time USN GF civilians intended to finance unusual employee expenses associated with overseas assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips and the travel advance account is subsequently reduced when travel expenses are incurred.
- **Financing payments** allow the USN GF to alleviate the potential financial burden that long-term contracts can cause to a contractor. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on costs, and interim payments under certain cost-reimbursement contracts.
  - **Contract financing payments** do not include invoice payments, payments for partial deliveries, or lease and rental payments.
  - **Progress payments** are only authorized based on a percentage or stage of completion and only for construction of real property; shipbuilding; and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as CIP. Due to system configuration limitations with certain entitlement systems, the USN GF incorrectly records Mechanization of Contract Administration Services estimated future contract financing payments as other assets, and those transactions have been reclassified to CIP and expenses.

1.R. Environmental and Other Contingent Liabilities

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity. Contingent liabilities are recognized when a past event or exchange transaction has occurred, and a future outflow of resources is probable and measurable. A contingency is considered probable when the future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, a contingency is considered probable when the future confirming event or events are likely to occur. A contingency is disclosed in the Notes to the Financial Statements if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. A contingency is considered reasonably possible when the chance of the future confirming event or events occurring is more than remote but less than probable. A contingency is not recognized as a contingent liability and an expense nor disclosed in the Notes to the Financial Statements when the chance of the future event or events occurring is remote. A contingency is considered remote when the chance of the future event or events occurring is slight.

Contingent Legal Liabilities are calculated based on a predetermined estimation methodology assessed and developed by Navy. In legal cases where estimated loss or reasonable loss range is not provided by legal offices, the estimation methodology estimates liability amounts based on historical payment to claim ratio. Navy Office of Financial Operations (FMO) will use OGC and Office of the Judge Advocate General (OJAG) attorney's likelihood assessment to categorize the cases for appropriate accounting treatment. The estimation methodology is based on the OGC and OJAG attorney's claim amount assessments and historical payout data applied to specific claim amounts.

Refer to Note 15, "Commitments and Contingencies" for additional information.

Environmental and Disposal Liabilities (E&DL) are estimates for anticipated environmental clean-up or disposal costs. The USN GF reports E&DL by estimating environmental clean-up (i.e., environmental restoration) or disposal costs for hazardous waste associated with future closure of GPP&E assets. Based on DoD FMR Volume 4 Chapter 13 (April 2018) and Title 40 Code of Federal Regulations, Environmental Protection Agency, Section 266.202, the USN GF does not report the environmental estimation and reporting of active ranges including the disposal of unexploded ordnance. The USN GF will recognize an environmental liability if hazardous waste is found to be migrating or has migrated off the range, or a formal decision is made to close the range.

The other accrued environmental restoration costs do not include the costs of environmental compliance, pollution prevention, conservation activities, contamination, or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations.

There are Environmental Liabilities accrued in Accounts Payable for work conducted but not paid, these amounts are not included in the Environmental and Disposal Liabilities Note 12.

Refer to Note 12, "Environmental and Disposal Liabilities" for additional information.

1.S. Accrued Leave

The USN GF reports unused military, compensatory, and civilian annual leave as accrued liabilities as it is earned. The accrued balance is adjusted annually to reflect current pay rates and unused hours of leave. The balance of the liabilities for annual leave and other leave (compensatory time and credit hours), including fringe benefit costs associated with the leave, must be assessed and, as needed, adjusted to reflect all pay increases and unused leave balances at least quarterly for financial statement purposes. Any portions of the accrued leave for which funding is not available, are recorded as unfunded liabilities. Sick leave for civilians is expensed as taken.

1.T. Net Position

Net position consists of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represent the amount of budget authority that is unobligated and has not been rescinded or withdrawn, as well as amounts obligated for which a legal liability for payment has not been incurred.

Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources including appropriations, revenue, and gains, since inception. The Cumulative Results of Operations also include donations and transfers in and out of assets that were not reimbursed.

1.U. Treaties for Use of Foreign Bases

The USN GF has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by State. The USN GF purchases capital assets overseas with appropriated funds; however, the host country retains title to the land and capital improvements. Treaty terms generally allow the USN GF continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, use of the foreign bases is prohibited and losses are recorded for the value of any non- retrievable capital assets. The settlement due to the U.S. or host nation is negotiated and considers the value of capital investments and may be offset by the cost of environmental cleanup.

1.V. Parent-Child Reporting

The USN GF is a party to allocation transfers with other federal agencies as a transferring "parent" entity or receiving "child" entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the Treasury as a subset of the parent fund account for tracking and reporting purposes. Generally, all financial activity related to these allocation transfers (e.g., budgetary resources, obligations incurred, gross costs, and outlays, gross) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and OMB apportionments are derived.

The USN GF also receives allocation transfers from Security Assistance programs and the U.S. Forest Service. The Security Assistance programs, Foreign Military Financing Program and the International Military Education and Training Program, meet the OMB exception for Executive Office of the President (EOP) funds, but they are reported separately from the USN GF's financial statements based on an agreement with OMB. The U.S. Forest Service activities are also reported separately from the USN financial statements and reported to the parent.

Conversely, as the parent, the USN GF provides allocation transfers to the Federal Highway Administration; all related activity is reported in the USN GF's financial statements.

1.W. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections recorded in the general ledger and those reported by the Treasury. Due to the nature of undistributed, there is a possibility both supported and unsupported adjustments may have been made to USN GF Accounts Payable and Accounts Receivable prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the USN GF generally cannot determine whether undistributed disbursements and collections should be applied to federal or non-federal Accounts Payable or Accounts Receivable at the time accounting reports are prepared. The USN GF records undistributed disbursements against non-federal Accounts Payable and undistributed collections against federal Accounts Receivable. In fiscal year 2020, the DON eliminated the overlay of general ledger disbursement and collection data in Defense Departmental Reporting System – Budgetary (DDRS-B). The overlay reversed the transaction level disbursement and collection data through recording of unsupported system-generated adjustments in DDRS-B in order to record undistributed amounts and agree to the net disbursement balances reported by Treasury. The elimination of the overlay also removes most of the direct feed of Defense Cash Accountability System (DCAS) data to DDRS-B and replaces the system-generated adjustments with manual supported and unsupported adjustments. These adjustments are recorded by the Defense Finance and Accounting Service (DFAS) to record the undistributed amounts and agree to the net disbursement balances reported by Treasury.

Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.X. Fiduciary Activities

Fiduciary activities are the collection or receipt, management, protection, accounting, investment and disposition by the federal government of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold. Fiduciary activities are not recognized on the entity's proprietary financial statements, but they are required to be disclosed on schedules in the notes to the financial statements. Fiduciary activities may involve a variety of transactions including, but are not limited to, cash, investments, other assets, liabilities, inflows, and outflows.

Refer to Note 19 "Fiduciary Activities" for additional information.

1.Y. Federal Employee and Veteran Benefits

For financial reporting purposes, the USN GF's actuarial liability for worker's compensation benefits is developed by DOL and provided to the USN GF at the end of each fiscal year. Military retirement is accounted for in the audited financial statements of the Military Retirement Fund. As such, the USN GF does not record any liabilities or obligations for pensions or healthcare retirement benefits.

1.Z. Tax Exempt Status

As an agency of the federal government, the USN GF is exempt from all income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government.

1.AA. Investments in Public-Private Partnerships

The USN GF discloses Public-Private Partnerships (P3s) in accordance with SFFAS 49. The USN GF adopted guidance for P3s which establishes principles for disclosure. USN GF considers certain partnerships as P3 arrangements, defined as risk-sharing arrangements or transactions lasting more than five years between public and private sector entities.

Refer to Note 21, "Public-Private Partnerships" for additional information.

1st Marine Division loads onto an MV-22B Osprey from Marine Medium Tiltrotor Squadron (VMM) 165, Marine Aircraft Group (MAG) 16, 3rd Marine Aircraft Wing (MAW), for a regimental air assault exercise. (U.S. Marine Corps photo by Warrant Officer Justin M. Pack)

NOTE 2. NON-ENTITY ASSETS

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Assets	
Fund Balance with Treasury	$ 230,266
Accounts Receivable	236
Total Intragovernmental Assets	230,502
Non-Federal Assets	
Cash and Other Monetary Assets	97,312
Accounts Receivable	118,246
Total Non-Federal Assets	215,558
TOTAL NON-ENTITY ASSETS	**446,060**
TOTAL ENTITY ASSETS	**669,555,998**
TOTAL ASSETS	**$ 670,002,058**

Non-entity Assets are assets held by the USN GF but are not available for the USN GF.

Intragovernmental FBwT is primarily comprised of amounts in the USN GF's Civilian Employee Allotments Account, Thrift Savings Plan, and Withheld State and Local Taxes Fund. These transactions are recorded in USN GF deposit funds. In addition, USN GF deposit funds include payroll withholdings from other DoD agencies until the funds are remitted to the appropriate taxing authority. As these are non-entity, they do not represent USN GF fund balance, liabilities or budget, rather they represent public funds that DoD is responsible for remitting at a future time. Due to financial system limitations, the USN GF performs manual reconciliations after the period-end close to categorize these adjustments as supported and unsupported.

Refer to Note 1.W "Undistributed Disbursements and Collections" for additional information.

Non-Federal Cash and Other Monetary Assets are disbursing officers' cash, foreign currency, and undeposited collections as reported on the Disbursing Officer's Statement of Accountability. These assets are held by USN GF disbursing officers' behalf of other agencies and are not available for the USN GF's use in normal operations.

Non-Federal Accounts Receivable are primarily contractor debts owed to cancelled general fund accounts. The balance also includes out-of-service employee debts owed to cancelled general fund accounts, and interest, penalty, and administrative charges for all other public debts that will be remitted to the Treasury Miscellaneous Receipts account.

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30 ($ in thousands)	Unaudited 2020
Status of Fund Balance with Treasury	
Unobligated Balance:	
Available	$ 30,459,508
Unavailable	3,284,244
Total Unobligated Balance	**33,743,752**
Obligated Balance not yet Disbursed:	**$ 157,025,389**
Non-Budgetary FBwT:	
Clearing Accounts	(1,051)
Deposit Funds	230,267
Total Non-Budgetary FBwT	**229,216**
Non-FBwT Budgetary Accounts:	
Investments-Treasury Securities	(5,043)
Unfilled Customer Orders without Advance	(4,564,623)
Receivables and Other Accounts	(147,571)
Total Non-FBWT Budgetary Accounts	**(4,717,237)**
Total Fund Balance with Treasury	**$ 186,281,120**

The Status of FBwT reflects the budgetary resources to support the FBwT and is a reconciliation between budgetary and proprietary accounts. The balances reflect the budgetary authority remaining for disbursement against current and future obligations.

Unobligated Balances are classified as available or unavailable and represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Certain unobligated balances may be restricted for future use and are not apportioned for current use. The Navy has not identified any such restricted balances.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods and services, but not paid.

Non-Budgetary FBwT is comprised of accounts that do not have budgetary authority but affect FBwT. This includes non-fiduciary deposit funds, budget clearing "suspense" account balances, and non-entity fund balance.

Non-FBwT Budgetary Accounts are required to reconcile the budgetary status to non-budgetary FBwT as reported in the balance sheet. Non-FBwT budgetary accounts create budget authority and unobligated balances, but do not post to FBwT as there has been no receipt of cash or direct budget authority, such as appropriations. The Non-FBwT budgetary accounts are comprised of investments in U.S. Treasury securities, unfilled customer orders without advance, and reimbursements receivable.

Other Additional Information

The USN GF field-level general ledger accounting systems may not include all Treasury collection and disbursement activity for reasons such as timing differences, transaction distribution errors, and disbursements made by other DoD agencies on behalf of the USN GF. Thus, the fund balance per USN GF includes undistributed disbursements and collections, representing the difference between disbursement and collections recorded with Treasury and those balances recorded within the USN GF general ledgers. The USN GF recorded $1.8 billion in undistributed disbursements and $239 million in undistributed collections as of September 30, 2020.

In FY 2020, the Navy transferred $1.9 billion in unused funds to the Department of Treasury, Miscellaneous Receipts account from General Fund Treasury Account Symbols that cancelled on September 30, 2020.

NOTE. 4. CASH AND OTHER MONETARY ASSETS

As of September 30 ($ in thousands)	Unaudited 2020
Cash	$ 55,559
Foreign Currency	41,753
Total Cash, Foreign Currency, & Other Monetary Assets	**$ 97,312**

Refer to Note 1.I, "Cash and Other Monetary Assets" for information

U.S. Marine Corps MV-22B Ospreys fly over Marine Corps Training Area Bellows in support of cherry picker drills. (U.S. Marine Corps photo by Sgt. Alex Kouns/Released)

NOTE 5. ACCOUNTS RECEIVABLE, NET

As of September 30 ($ in thousands)	Unaudited 2020		
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net
Intragovernmental Receivables	$ 253,390	$ —	$ 253,390
Non-federal Receivables (With the Public)	71,703	(26,364)	45,339
Total Accounts Receivable	**$ 325,093**	**$ (26,364)**	**$ 298,729**

Accounts Receivable, Net represents the USN GF's claim for payment from federal and non-federal sources.

Intragovernmental Receivables primarily represent amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Seller-side accounts receivable are adjusted to agree with inter-/intra-agency buyer-side's accounts payable through the USN GF's elimination process when buyer- side balances are deemed more reliable.

Non-federal Receivables (With the public) are balances due from individuals and organizations. Examples include, Accounts Receivable pertaining out of service debts and military housing. These balances, once collected, may be used by the collecting agency based upon nature of Accounts Receivable.

The DON's gross amount due for Non-federal Receivables (With the Public) include amounts related to criminal restitution owed to the government. In FY 2020, accounts receivable, net included $0.6 million of gross receivable related to criminal restitution orders monitored by DFAS, of which no collections are expected to be made since debts are more than two years delinquent.

Restitution receivables and associated payments are pursued by the courts handling those cases. Receivables are established based on the court documents received and posts payments received through the courts. At two years delinquent, criminal restitution receivables are considered 100 percent uncollectible; however, the DON is only authorized to write off or close accounts with approval from the Department of Justice.

Due to limitations of financial and nonfinancial management processes and systems that support the financial statements, the DON is unable to separately identify the USN GF and the DON WCF criminal restitution receivables.

Refer to Note 1.J, "Accounts Receivable" for additional information.

NOTE 6. INVENTORY AND RELATED PROPERTY, NET

OPERATING MATERIALS AND SUPPLIES, NET

As of September 30 ($ in thousands)	Unaudited 2020			
	Gross Value	Revaluation Allowance	Net	Valuation Method
OM&S Categories				
Held for Use:				
Ordnance	$ 32,304,556	$ —	$ 32,304,556	MAC
Uninstalled Aircraft Engines	2,919,730	—	2,919,730	LAC, HC
Remainder	17,764,282	—	17,764,282	LAC, MAC
Total Held for Use	**52,988,568**	—	**52,988,568**	
Held in Reserve for Future Use:				
Ordnance	13,075,780	—	13,075,780	MAC
Trident Missiles	10,395,976	—	10,395,976	LAC
Uninstalled Aircraft Engines	3,654,767	—	3,654,767	LAC, HC
Remainder	6,963,353	—	6,963,353	LAC, MAC
Total Held in Reserve for Future Use	**34,089,876**	—	**34,089,876**	
In Development:				
OM&S in Development	579,877	—	579,877	LAC, MAC
Total In Development	**579,877**	**—**	**579,877**	
Excess, Obsolete, and Unserviceable:				
Ordnance	946,927	(946,927)	—	NRV
Uninstalled Aircraft Engines	953,182	(953,182)	—	NRV
Remainder	27,019	(27,019)	—	NRV
Total Excess, Obsolete, and Unserviceable	**1,927,128**	**(1,927,128)**	—	
Total	**$ 89,585,449**	**$ (1,927,128)**	**$ 87,658,321**	

Legend for Valuation Methods:			
HC= Historical Cost	LAC = Latest Acquisition Cost	MAC = Moving Average Cost	NRV = Net Realizable Value

The USN GF's OM&S consists of tangible personal property to be consumed in normal operations or as part of a larger asset assembly. The USN GF classifies its OM&S into four categories based on purpose or condition: held for use, held in reserve for future use, EOU and OM&S in development.

OM&S designation is determined based on condition codes assignment, as defined by the Defense Logistics Manual 4000.25-2, *Defense Logistics Management Standards*, and subsequent alignment to account categories as directed in the DoD Financial Management Regulation 7000.14-R, Volume 4, Chapter 4 paragraph 040304.

Held for Use consists of all other serviceable (ready for issue) material.

Held in Reserve for Future Use consists of OM&S stocks that may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily

in the normal course of operations. OM&S held in reserve for future use are valued using the same basis as operating materials and supplies held for use in normal operations. OM&S materials held for repair are reported under held in reserve for future use.

OM&S in Development are costs incurred in developing the OM&S or the value of tangible personal property that will be consumed in normal operations upon completion of development.

Excess, Obsolete, and Unserviceable materials are damaged assets that are more economical to dispose of than repair. Materials are defined as follows; "Excess operating materials and supplies" are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management's criteria to be held in reserve for future use. "Obsolete operating materials and supplies" are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable operating materials and supplies" are operating materials and supplies that are physically damaged and cannot be consumed in operations.

The USN GF further identifies OM&S by unique acquisition-based segments: ordnance (e.g., ammunition, conventional missiles and torpedoes), Trident missiles (submarine launched nuclear capable ballistic missiles), centrally managed Uninstalled Aircraft Engines, and OM&S Remainder (OM&S-R). OM&S -R includes, but is not limited to, all non-ordnance materials, uninstalled modification kits, spares and repair parts for major end items (e.g., ships, aircraft, tanks), clothing, textiles, and petroleum products.

The USN GF has no restrictions on the use of OM&S.

U.S. Navy Seabees are constructing two pre-engineered buildings for Naval Beach Unit 7 to prevent the deterioration of their equipment and increase their lethality within the region. (U.S. Navy photo by Steelworker 2nd Class Douglas Dooley/Released)

NOTE 7. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

As of September 30 ($ in thousands)	Unaudited 2020				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Land	N/A	N/A	$ —	$ —	$ —
Buildings, Structures, Linear Structures	S/L	35, 40 or 45	172,992,382	(143,293,218)	29,699,164
Utilities	S/L	35 or 40	15,881,704	(11,112,266)	4,769,438
Leasehold Improvements	S/L	Lease Term	6,530	(6,530)	—
Software	S/L	2-5 or 10	224,641	(9,868)	214,773
General Equipment:					
Vessels	S/L	20-50	340,679,251	(162,955,371)	177,723,880
Aircraft	S/L	15-30	178,733,513	(89,668, 459)	89,065,054
Satellites	S/L	7-13	4,304,454	(2,932,924)	1,371,530
General Equipment-Remainder	S/L	Various	22,259,900	(16,176,135)	6,083,765
Total General Equipment			545,977,118	(271,732,889)	274,244,229
Construction-in-Progress	N/A	N/A	84,648,707	—	84,648,707
Other	S/L	35, 40 or 45	10,052,620	(9,592,590)	460,030
Total General PP&E			**$ 829,783,702**	**$ (435,747,361)**	**$ 394,036,341**

Legend for Depreciation/Amortization Method:	
N/A = Not Applicable	S/L = Straight Line

The USN GF's GPP&E is comprised of unique asset lifecycle-based categories: real property (buildings, structures, linear structures and utilities); IUS; GE and, CIP (real property and GE). The USN GF further identifies GE by major acquisition-based segments: vessels (ships and submarines), aircraft, satellites, and GE remainder (e.g., all other capitalized assets not specifically identified, including operation support equipment, small boats and service craft, maintenance support equipment). Other GPP&E consists of "caretaker" real property. Caretaker real property is unutilized, meaning it is not occupied for current USN GF program purposes. The USN GF provides minimal maintenance to caretaker real property to ensure its safety and security only. Caretaker property is often awaiting disposal action but can also be returned to active use.

The NRV for USN GF land was adjusted to zero in accordance with SFFAS 50. The USN GF owns 2,092 thousand acres of land as of September 30, 2020. The USN GF uses land, buildings, and other overseas facilities obtained through various international treaties and agreements negotiated by the State. Generally, treaty terms allow the USN GF continued use of these properties until the treaties expire. There are no other known restrictions on GPP&E.

Refer to Note 1.M, "General Property, Plant and Equipment" for additional information.

As of FY 2020, Navy implemented the Office of the Secretary of Defense (OSD) Real Property Financial Reporting Responsibilities (FRO) Policy Update, dated March 15, 2019. The policy requires the USN GF financial statements to recognize all real property assets (i.e., buildings, land, structures, and linear structures) located and aligned to Navy installations, including all DON WCF real property assets located and aligned to Navy installations. This includes the

recognition of any capital improvements associated with DoD-owned assets. The DON WCF will continue to report to USN GF instances that they are the installation host, real property assets that are on other federal agency installations or land or private property sites, and leased facilities and the associated improvements that are not on DoD land, if applicable.

In FY 2020, Navy completed the assessment of July 2019 China Lake earthquake and concluded that 1,508 assets were damaged but are intended to be fully repaired, 214 assets are scheduled to be disposed of, and 8 assets incurred no damage. On July 12, 2020, an explosion occurred aboard USS Bonhomme Richard while in home port at Naval Base San Diego undergoing maintenance and the ship sustained significant damages.

Ensign monitors the horizon for surface and air contacts in the pilot house of the guided-missile destroyer USS Sterett (DDG 104) in the North Arabian Sea. (U.S. Navy photo by Mass Communication Specialist Seaman Drace Wilson)

NOTE 8. STEWARDSHIP PP&E

HERITAGE ASSETS

As of September 30	Unaudited 2020			
Heritage Asset Categories	Beginning Balance	Additions	Deletions	Ending Balance
Building and Structures	364	—	125	239
Archaeological Sites	—	—	—	—
Museum Collection Items (Objects, Not Including Fine Art)	482,859	1,697	42	484,514
Museum Collection Items (Objects, Fine Art)	34,088	107	247	33,948

The USN's policy is to preserve its heritage assets; which are items of historical, cultural, educational, or artistic importance.

The overall mission of the USN is to control and maintain freedom of the seas, project power beyond the sea, and influence events and advance U.S. interests across the full spectrum of military operations. The USN is a large-scale owner of historic buildings, structures, districts, historical artifacts, art, ships, sunken ships, aircraft, archeological sites, installation and stewardship land, and other cultural resources. Protection of these components of the nation's heritage assets and stewardship land is an essential part of USN's mission. The USN is committed to responsible heritage asset and cultural resources stewardship.

Heritage assets receive such designation, and have such designation withdrawn, through the accessioning and deaccessioning procedures for USN GF collections, or through evaluation in compliance with the National Historic Preservation Act. Designation is in accordance with the standards articulated with the collection scopes and collecting plans, or by application of the criteria of the National Register of Historic Places. Heritage assets within the USN GF consist of buildings, structures, archaeological sites and museum-type collections. The USN GF defines these as follows:

Buildings and Structures: Buildings and structures that are listed on, or eligible for listing on, the National Register of Historic Places, including multi-use heritage assets. This also includes sunken military craft, as defined by the Sunk Military Craft Act, which are managed as heritage assets. As of September 30, 2020, there are 239 items classified as buildings and structures.

Archaeological Sites: Sites that have been identified, evaluated, and determined to be eligible for or are listed on the National Historical Places in accordance with Section 110 of the National Historical Preservation Act.

Museum-type Collection Items: Art and artifacts that have been formally accessioned into a USN GF collection for the purpose of display or exhibition. As of September 30, 2020, there are 518,462 museum-type collection items, consisting of 33,948 objects (fine art) and 484,514 objects (not including fine arts).

STEWARDSHIP LANDS

As of September 30		Unaudited 2020			
Facility Code	Facility Title	Beginning Balance	Additions	Deletions	Ending Balance
9120	Withdrawn Public Land	1,371	—	—	1,371
9130	Licensed and Permitted Land	1	—	1	—
9140	Public Land	5	—	—	5
	Grand Total				**1,376**
	TOTAL - All Other Lands				**—**
	TOTAL - Stewardship Land				**1,376**

Stewardship Land is land and land rights owned by the federal government but not acquired for or in connection with items of GPP&E. Examples of stewardship land include land used as forests and parks, and land used for wildlife and grazing.

Reagan, the flagship of Carrier Strike Group 5, provides a combat-ready force that protects and defends the collective maritime interests of its allies and partners. (U.S. Navy photo by Mass Communication Specialist 3rd Class Erica Bechard/Released)

NOTE 9. OTHER ASSETS

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Other Assets	
Advances and Prepayments	$ 1,102,417
Investments, Net (including accrued interest)	5,071
Total Intragovernmental Other Assets	**1,107,488**
Non-Federal Other Assets	
Outstanding Contact Financing Payments	347,031
Advances and Prepayments	174,569
Other Assets (With the Public)	1,147
Total Non-Federal Other Assets	**522,747**
Total Other Assets	**$ 1,630,235**

Intragovernmental Advances and Prepayments are cash outlays made by a federal entity to cover all or part of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity will receive. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Intragovernmental Investments, Net represent USN GF Trust Fund holdings in interest-bearing securities for the Naval Academy General Gift Fund and the Navy General Gift Fund. These investments are nonmarketable, market- based Treasury securities reported at cost, net of amortized premiums and discounts. Additionally, USN GF Trust Funds are reported as funds from dedicated collections. As of September 30, 2020, the market value of these investments is $5.1 million.

Non-Federal Outstanding Contract Financing are authorized disbursements of monies to a contractor prior to the acceptance of supplies or services.

Non-Federal Advances and Prepayments. In efforts to improve the financial reporting of other asset balances, the USN GF recorded a reclassification of the OCFP balance to CIP and expense. The USN GF will continue to record this reclassification until the financial systems are able to accurately record these balances.

Non-Federal Other Assets (With the Public) consists of advance pay to USN GF military personnel, travel advances to military and civilian personnel, and miscellaneous advances to contractors that are not considered outstanding contract financing payments.

THIS PAGE INTENTIONALLY LEFT BLANK

NOTE 10. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Liabilities	
Other	$ 302,273
Total Intragovernmental Liabilities	**302,273**
Non-Federal Liabilities	
Accounts Payable	311,005
Federal Employee and Veteran Benefits	1,362,044
Environmental and Disposal Liabilities	25,224,975
Accrued Unfunded Annual Leave	3,036,558
Other	45,488
Total Non-Federal Liabilities	**29,980,070**
Total Liabilities Not Covered by Budgetary Resources	**30,282,343**
Total Liabilities Covered by Budgetary Resources	**18,852,321**
Total Liabilities	**$ 49,134,664**

Other Intragovernmental Liabilities primarily consists of unfunded FECA liabilities due to the DOL and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Accounts Payable consists of accounts payable related to appropriations that have cancelled.

Federal Employment and Veteran Benefits consist of unfunded FECA actuarial liabilities not due and payable during the current fiscal year.

Environmental and Disposal Liabilities are estimates related to future events and consist of liabilities related to cleanup or disposal of active installations, Base Realignment and Closure (BRAC) sites, and equipment and weapons programs.

Refer to Note 12, "Environmental and Disposal Liabilities," for additional information.

Accrued Unfunded Annual Leave represents the unfunded portion of accrued leave recorded as an unfunded liability.

Other Non-Federal Liabilities includes estimated legal contingent liabilities, and cancelled accounts payable as impacted by undistributed adjustments, and the disposal of excess structures that are not currently budgeted for, but will become funded as future events occur. The USN GF continues to partner with its service provider to research and correct undistributed transactions to reduce the impact on the accounts payable balance.

Liabilities Not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided to cover the liabilities. These include liabilities resulting from the receipt of goods or services in current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through congressional appropriations or earnings of the entity.

Liabilities Covered by Budgetary Resources includes Accounts Payable amounts owed to federal and non-federal entities for goods and services received by the USN GF.

The USN GF's systems do not track intragovernmental accounts payable transactions by customer. As a result, in the intragovernmental eliminations process, buyer-side accounts payables are adjusted to agree with inter/intra-agency seller-side accounts receivables. The USN GF's methodology for adjusting Accounts Payables consist of (1) reclassifying amounts between federal and non-federal accounts payable and (2) applying both supported and unsupported undistributed disbursements at the reporting entity level. The USN GF is continuing to record accrual entries ($11.9 billion at the end of FY 2020) to account for non-federal accounts payable. These accrual entries are completed to record the estimated amount of cost incurred and goods or services received but not invoiced.

Due to existing system limitations, Navy is not consistently performing receipt and acceptance activities that would record Accounts Payables in the General Ledger (GL) systems or accruing for goods or services received but not invoiced or paid. As such, the Navy executes an Accounts Payable estimation accrual methodology to estimate the final Accounts Payable balance at the end of each quarter.

Refer to Note 1.W, "Undistributed Disbursements and Collections" for additional information.

A MV-22B Osprey assigned to Marine Operational Test and Evaluation Squadron 1 lands on the flight deck of the aircraft carrier USS Carl Vinson (CVN 70). (U.S. Navy photo by Mass Communication Specialist 3rd Class Matthew Brown/Released)

NOTE 11. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30 ($ in thousands)	Unaudited 2020		
	Liability	(Less: Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits			
Federal Employee's Compensation Act	$ 1,362,044	$ —	$ 1,362,044
Other	889	(889)	—
Total Federal Employee and Veteran Benefits	**$ 1,362,933**	**$ (889)**	**$ 1,362,044**

Federal Employee and Veteran Benefits consist of FECA and other benefits. Military retirement and other federal employment benefits are accounted for in the audited financial statements of the Military Retirement Fund.

FECA amounts consist of amounts for federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. The USN GF reports an actuarial liability for the FECA. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for military pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the DoD consolidated level.

Actuarial Cost Method Used and Assumptions

The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims.

DOL calculates the future workers' compensation liability using wage inflation factors (e.g., cost of living adjustment or COLAs) and medical inflation factors (e.g., consumer price index medical (CPIM)). The actual rates for these factors for charge back year (CBY) 2020 were also used to adjust the methodology's historical payments to current year constant dollars.

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Year over year changes in the liability were also examined, with any significant agency-level differences inspected in greater detail. DOL concluded that the model has been stable and has projected each agency's actual payments well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Department of the Treasury's Yield Curve for Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.41% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.30% was assumed for year one and years thereafter.

Other represents additional post-employment benefits, which can include salary continuation, severance benefits, counseling, training, funded unemployment liability for federal employees, funded FECA liability, and the current portion of veterans' disability compensation benefits.

NOTE 12. ENVIRONMENTAL AND DISPOSAL LIABILITIES

As of September 30 ($ in thousands)	Unaudited 2020
Accrued Environmental Restoration Liabilities	
Active Installations - Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	$ 3,969,475
Active Installations - Military Munitions Response Program (MMRP)	1,919,629
Base Realignment and Closure Installations	
Installation Restoration Program	1,634,286
Military Munitions Response Program	102,566
Environmental Corrective Action/Closure Requirements	3,750
Environmental Disposal for Military Equipment/Weapons Programs	
Nuclear Powered Military Equipment/Spent Nuclear Fuel	16,514,188
Other Weapons Systems	380,489
Other Accrued Environmental Liabilities - Non-BRAC	
Environmental Corrective Action	95
Environmental Closure Requirements	333,074
Asbestos	309,396
Non-Military Equipment	58,027
Total Environmental and Disposal Liabilities	**$ 25,224,975**

The USN GF reports the estimated environmental clean-up or disposal costs for hazardous waste associated with future closure of GPP&E assets and consist of liabilities related to accrued environmental restoration liabilities (ERN), BRAC, environmental disposal for military equipment/weapons programs (disposal) and other accrued environmental liabilities (OEL) Non-BRAC.

Applicable Laws and Regulations for Cleanup, Closure and Disposal Requirements

The following is a list of significant laws that affect the USN GF's conduct of environmental policy and regulations:

- Resource Conservation and Recovery Act of 1976, as amended by the Hazardous and Solid Waste Amendments of 1984
- Superfund Amendments and Reauthorization Act (SARA)
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Atomic Energy Act
- Nuclear Waste Policy Act
- Low Level Radioactive Waste Policy Amendments Act
- Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
- Medical Waste Tracking Act
- DoD FMR Volume 4, Chapter 13: "Environmental and Disposal Liabilities"

- SFFAS 5, "Accounting for Liabilities of the Federal Government"
- SFFAS 6, "Accounting for Property, Plant, and Equipment"
- Department of the Defense Environmental Restoration Program (DERP) Manual
- DoD FMR, Volume 6B, Chapter 10: "Notes to the Financial Statements"
- FASAB Technical Release (TR) 2, Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government Page 2 of 27
- FASAB TR 10, Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment
- FASAB TR 11, Implementation Guidance on Cleanup Costs Associated with Equipment
- FASAB TR 14, Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment
- FASAB Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Cost, amended by FASAB under Technical Bulletin 2011-2, Extended Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos- Related Cleanup Costs

Types of Environmental and Disposal Liabilities Identified

Accrued Environmental Restoration Liabilities

Active Installations - DERP funded activities may be conducted at operating installations under the Installation Restoration Program (IRP) and at closed, transferred, and transferring munitions ranges under the Military Munitions Response Program (MMRP). Developing a cleanup cost estimate relies on several factors that include: the current cost basis, the anticipated actions required to complete the cleanup, and applicable legal and or regulatory requirements. In addition, program management, environmental corrective action, and support costs are also included. The estimate produced is based on site- specific information. The cost estimates are developed and maintained in the SN Normalization of Data System database. Such cost estimates are based on the current technology available.

MMRP liabilities are specific to the identification, investigation, removal, and remedial actions to address environmental contamination for munitions specific sites. The contamination may include munitions, chemical residues from military munitions, and munitions scrap at ranges on active installations that pose a threat to human health or the environment. Cost to complete (CTC) is not estimated until there is sufficient site-specific data available to estimate the total CTC. However, USN GF uses the cost of the study as the estimate until the study is completed.

As of September 30, 2020, the USN GF estimated and reported $5.9 billion for environmental restoration liabilities. This amount is comprised of $1.9 billion in active installations-IRP liabilities and $3.9 billion in Active Installations- MMRP liabilities.

Between FY 2019 and FY 2020, the Navy determined that two sites associated with the underwater munition response program should be adjusted to only reflect site investigation costs. All other costs associated with remediation activities (i.e. dredging) have been removed from these sites until the full cost study has been finalized due to the determination that these cost estimates could not be fairly estimated and supported. This resulted in a decrease to these two sites in the amount of $248 million. The cost study is expected to be finalized in FY21 and the Cost to Complete for these two sites will be adjusted appropriately at that time.

Base Realignment and Closure Installations

Congress commissioned to provide an independent review and analysis of bases and military installations that the DoD recommended be closed and/or operationally realigned and provided their recommendations in the BRAC Commission Final Report to the President. There have been five rounds of BRAC; 1988, 1991, 1993, 1995, and 2005.

BRAC environmental sites are environmental sites at USN GF installations that are or will be closed under the congressionally mandated BRAC process. As of September 30, 2020, the USN GF has estimated and reported $1.7 billion for BRAC funded environmental liabilities. This amount includes $1.6 billion for IRP, $102.6 million for MMRP, and $3.7 million for Compliance.

Environmental Disposal for Military Equipment/Weapons Programs

Environmental Disposal for Military Equipment/Weapons Programs estimates represents environmental disposal liabilities related to the final disposition of military equipment. Military equipment is composed of two different areas (1) USN GF vessels which include active and inactive assets, such as weapon systems and other equipment designed to carry out battlefield missions, which include conventional (non-nuclear) and nuclear- powered active and inactive ships, aircraft carriers, submarines, and spent nuclear fuel (SNF), and (2) all USN GF active and nonactive aircraft. Currently, the USN GF does not report any Nuclear Component Weapons (Trident missiles) as these have been identified as the sole responsibility of the Department of Energy.

As of September 30, 2020, environmental disposal estimates for nuclear powered military equipment and SNF is $16.5 billion and $380.5 million for other weapons disposal (non-nuclear) in recognized liability. The unaccrued portion of such estimates is reported as unrecognized costs. The USN GF's unrecognized environmental cleanup cost for GPP&E is $3.9 billion for nuclear powered military equipment, $264.5 million for SNF, and $203.5 million for other weapons disposal (non-nuclear).

The USN GF and the Department of Energy share estimated future costs of disposing high-level waste and SNF. The portion of SNF reflected on the USN GF's Balance Sheet represents the USN GF's portion of the estimated future cost based on historical cost factors, which equates to $2.8 billion in recognized liability.

The demilitarization and disposal of Nuclear Aircraft Carriers has never been performed before. The hazardous waste disposal estimate related to the current active fleet and one decommissioned vessel amounts to $9 billion, which is 36% percent of the Navy's overall recognized E&DL balance and $3 billion in unrecognized E&DL disposal costs. The Navy's Nuclear Carrier fleet has begun its first disposal effort for one Nuclear Carrier. The Navy has conducted preliminary analysis for this first Nuclear Carrier disposal through private enterprise and government research and used that analysis as the basis for a detailed but unproven estimate for that specific carrier and as a broad basis for an estimate of the future disposal cost of the currently active carriers. No decisions have been made as to the actual remaining life of the other classes of active aircraft carriers. The second class of carriers is on schedule for consideration in six years, which aligns with their expected useful life. That class of carriers was designed, when built, to have a 50 year life and the first ship in the class was commissioned in 1975. Due to the unique aspects of demilitarization and disposal of nuclear components for a vessel that large and the lack of any available data related to the costs and techniques to be used in such a disposal, there is a significant risk that the projected estimates for the decommissioned carrier may vary widely from future incurred actual disposal costs. Therefore, the estimates for the remainder of the fleet that are based on that estimate may change materially over the remaining active life of the carriers. The Navy expects that once the first Nuclear Carrier has begun its disposal process this information will allow adjustments of the estimates based on the experience of actual costs, new technology, and other lessons learned in the disposal process. The nuclear aircraft hazardous material disposal estimate will be continuously evaluated and adjusted as this information becomes available.

As of September 30, 2020, the environmental disposal liability for Military Ground Equipment, equates to a range of $5 million to $17.5 million. This range was determined to be immaterial to the Navy's financial statement and has not been included in the other weapons disposal (non-nuclear) recognized liability amount.

Other Accrued Environmental Liabilities – Non-BRAC

The OEL segment prepares accounting estimates for the unique clean-up costs that will be incurred when USN GF GPP&E

assets are decommissioned. The estimate is only prepared for those assets determined to have unique cleanup costs associated with hazardous waste or materials at the time of decommissioning. This includes estimates of environmental cleanup costs upon asset closure, addressing hazardous waste, asbestos, and lead, in addition to mandated cleanup of petroleum residuals and lubricants, these estimates are recognized as cleanup costs to current operating procedures. The OEL segment also reports estimated costs to remediate existing environmental damage at active USN GF facilities, when such costs are not eligible for funding from DERP.

The USN GF's estimated recognized environmental cleanup cost for GPP&E totaled $700.6 million as of September 30, 2020. For closure sites, nonmilitary equipment and asbestos-abatement units placed in service after a threshold date, only part of estimated costs is immediately recognized as an environmental liability. The un-accrued portion of such estimates is reported as unrecognized costs. The USN GF's unrecognized environmental cleanup cost for GPP&E totaled $105.9 million.

For FY 2020, due to environmental estimation uncertainties there is a possibility that environmental liabilities could increase to approximately $593.2 million, which also includes uncertainty concerning asbestos abatement.

As of September 30, 2020, the Navy is in the process of capturing General Equipment captured outside of the Defense Property Accountability System (DPAS) and estimated a disposal liability for those assets which equates to a range of $15.7 million to $88.0 million. This range was determined to be immaterial to the Navy's financial statement.

Asbestos-Related Cleanup Costs

The Department maintains structures and facilities that may contain asbestos material in the construction or renovation. Due to asbestos being difficult to identify pre-construction or until demolition occurs the Navy does not conduct separate or distinct estimates for friable and non-friable asbestos. Once identified as containing or believed to contain asbestos, the Navy considers the entire property as requiring asbestos remediation upon demolition and disposal of the property.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

When the environmental cost estimates are completed, the USN GF complies with accounting standards to assign cost to the current operating period through amortization.

Accrued Environmental Restoration Liabilities

DERP represents the liability to correct past releases of hazardous constituents from USN GF GPP&E and to bring the known contaminated sites into compliance with the applicable environmental standards. Currently, the USN GF process is to perform an initial assessment of any contamination before the USN GF purchases a new building or land. Any identified contamination is reported as a liability and an associated cost to complete is conducted on an annual basis; these estimates are recognized as cleanup costs to current operating procedures. Estimates are developed using engineering estimates.

Other Accrued Environmental Liabilities Non-BRAC

The OEL program relied on a historic fence-to-fence survey and currently relies on multiple Accountable Property Systems of Records (APSRs) to derive and recognize liabilities associated with the decommissioned assets over real property and general equipment- remainder. These APSRs include: Internet Naval Facilities Data Storage System, NERP, and Defense Property Accountability System. On an annual basis, APSRs are reviewed and the estimate is updated to reflect the changes in the inventory. Environmental conditions that result from current operations and require immediate cleanup (e.g., oil spills or routine hazardous waste removal) are not considered environmental liabilities and are part of current operating expense, if fully remediated within the current fiscal year. Estimates are developed using a combination of engineering estimates and cost model derived from the RSMeans engineering software.

Base Realignment and Closure

Once an installation is closed, the DERP associated liabilities for these sites are transferred to the BRAC program, which may include sites on property USN GF may no longer own, but for which the USN GF has retained clean-up responsibility based on property transfer agreements. BRAC's universe consists of environmental liabilities for environmental restoration program sites at closed USN GF installations; the estimates are recognized as cleanup costs to current operating procedures and are estimated annually.

Environmental Disposal for Military Equipment/Weapons Programs

There are two USN GF commands responsible for estimating environmental disposal liabilities related to military equipment and weapons programs. The estimates are developed based on the population of their respective APSRs. NAVSEA develops quarterly updates and maintains the estimate for vessels and NAVAIR develops quarterly updates and maintains the estimate for all USN GF aircraft. Estimates are developed using engineering estimates.

Nature of Estimates and the Disclosure of Additional Information

Estimated environmental liabilities are extremely complex with various input factors. In addition, these input factors are adjusted for new technology, price growth (inflation), increases in labor rates, and materials. As of September 30, 2020, there are no changes to the environmental liability estimates due to inflation, deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The USN GF is not aware of any pending changes, but the liability can change in the future due to changes in laws and regulations, changes in agreements with regulatory agencies, and advances in technology.

Environmental Liabilities

The environmental liabilities for USN GF are based on accounting estimates, which require certain judgments and assumptions that are reasonable based upon information available at the time the estimates are calculated. The actual results may materially vary from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than used for (or) assumed for calculating the estimates. Liabilities can be further affected if investigation of the environmental sites reveals contamination levels that differ from the estimate parameters.

Civil service mariners assigned to the Blue Ridge-class command and control ship USS Mount Whitney (LCC 20) watch an MH-60 Sea Hawk helicopter take off. (U.S. Navy photo by Mass Communication Specialist 2nd Class Damon Grosvenor/Released)

NOTE 13. OTHER LIABILITIES

As of September 30 ($ in thousands)	Unaudited 2020		
	Current	Non-Current	Total
Intragovernmental			
Advances from Others	$ 10,023	$ —	$ 10,023
Disbursing Officer Cash	98,938	—	98,938
Judgment Fund Liabilities	1,391	—	1,391
FECA Reimbursement to the Dept of Labor	121,554	145,848	267,402
Custodial Liabilities	114,508	—	114,508
Employer Contribution and Payroll Taxes Payable	116,716	—	116,716
Other Liabilities	35,821	—	35,821
Total Intragovernmental Other Liabilities	**498,951**	**145,848**	**644,799**
Non-Federal			
Accrued Funded Payroll and Benefits	1,386,752	—	1,386,752
Advances from Others	810,089	—	810,089
Deposit Funds and Suspense Accounts	229,216	—	229,216
Contract Holdbacks	1,183,839	—	1,183,839
Employer Contribution and Payroll Taxes Payable	314,451	—	314,451
Contingent Liabilities	—	45,488	45,488
Other Liabilities	38,301	—	38,301
Total Non-Federal Other Liabilities	**3,962,648**	**45,488**	**4,008,136**
Total Other Liabilities	**$ 4,461,599**	**$ 191,336**	**$ 4,652,935**

Intragovernmental Liabilities:

Intragovernmental Advances from Others represent liabilities for collections received to cover future expenses or acquisitions of assets.

Intragovernmental Disbursing Officer Cash represents liabilities for currency on hand, cash on deposit at designated depositories, cash in the hands of depositories, cash in the hands of deputy disbursing officers, cashiers and agents, negotiable instruments on hand, and other related liabilities.

Intragovernmental Judgment Fund Liabilities represent the amount due from USN GF, payable to the Treasury Judgment Fund. This is the amount for losses arising from legal cases paid by the Treasury Judgment Fund on USN GF's behalf, but reimbursable to the Treasury Judgment Fund.

Intragovernmental FECA Reimbursement to the Department of Labor represent the liabilities chargeback amount for payments made by DOL on the behalf of the USN GF.

Intragovernmental Custodial Liabilities represent liabilities for collections reported as non-exchange revenues where the USN GF is acting on behalf of another federal entity. The Statement of Custodial Activity is not required as part of the USN GF's financial statements, as they are reflected on the Balance Sheet.

Intragovernmental Other Liabilities represents liabilities not recognized in any previous category and includes liabilities that are immaterial to the agency.

Non-Federal Liabilities:

Non-Federal Accrued Funded Payroll and Benefits represents the estimated liability for salaries and wages of civilians and military members that have been earned but are unpaid and amounts of funded annual leave, sick leave, and other employee benefits that have been earned but unpaid.

Non-Federal Advances from Others represent liabilities for collections received from public to cover future reimbursable expenses.

Non-Federal Deposit Funds and Suspense Accounts represent liabilities for receipts held in suspense temporarily for distribution to another fund or entity or held as an agent for others and paid at the direction of the owner.

Non-Federal Contract Holdbacks consist of amounts withheld from payments to contractors to assure compliance with contract terms, usually expressed as a percentage in the respective contract provisions.

Non-Federal Contingent Liabilities include accrued contingent legal liabilities pertaining to pending legal cases where the OGC and the Office of the Judge Advocate General (OJAG) consider an adverse decision probable and the amount of the loss measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury Judgment Fund.

Refer to Note 15, "Commitments and Contingencies," for additional information.

Non-Federal Other Liabilities primarily consist of accruals for services, accrued liabilities for inventory owned and managed on behalf of foreign governments, and undistributed international tariff receipts.

NOTE 14. LEASES

Operating Leases:

Future Payments Due for Non-Cancellable Operating Leases

As of September 30 ($ in thousands)	Unaudited 2020		
	Asset Category		
	Land and Buildings	Equipment	Total
Federal Leases			
Future Payments Due Fiscal Year			
2021	$ 38,428	$ 38	$ 38,466
2022	39,125	20	39,145
2023	39,985	20	40,005
2024	40,864	20	40,884
2025	41,762	21	41,783
After 5 Years	42,680	21	42,701
Total Federal Future Lease Payments	**$ 242,844**	**$ 140**	**$242,984**
Non-Federal Leases			
Future Payments Due Fiscal Year			
2021	$ 170,060	$ —	$ 170,060
2022	173,366	—	173,366
2023	176,820	—	176,820
2024	180,344	—	180,344
2025	183,937	—	183,937
After 5 Years	187,612	—	187,612
Total Non-Federal Future Lease Payments	**$ 1,072,139**	**$ —**	**$ 1,072,139**
Total Future Lease Payments	**$ 1,314,983**	**$140**	**$ 1,315,123**

All USN GF leases are non-cancellable operating leases. Operating lease amounts are captured by asset category for the next five years and beyond. These future operating lease payments will be funded by future year's budgetary resources. Currently, the USN GF does not have any future payments for cancellable leases. The USN GF is not aware of any lease agreements in which we are the Lessor.

NOTE 15. COMMITMENTS AND CONTINGENCIES

Commitments:

Commitments are preliminary actions that will ultimately result in an obligation to the U.S. government if carried through, such as purchase requisitions, estimated travel orders, or unsigned contracts/grants. The USN GF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the USN GF does not have a systemic process by which it captures or assesses these potential contingent liabilities. Therefore, the amounts reported may not fairly present the USN GFs contingent liabilities.

The USN GF's estimate of obligations related to cancelled appropriations for which the USN GF has a contractual commitment for payment is $291.4 million.

Other Contingencies:

As of September 30, 2020, the DON documented internal administrative claims (IACs) within the Office of the Judge Advocate General (OJAG) Code 11 and OJAG Code 15 and assessed their financial statement impact related to Contingent Liability/Contingent Loss (CL). IACs are analyzed by litigators to determine whether in accordance with applicable guidance they must be disclosed as threatened/unasserted litigation pursuant to the Contingent Legal Liability (CLL) reporting process. IACs that do not qualify as reportable in the CLL context may need to be disclosed as part of DON's broader CL reporting. The DON conducted an analysis of open claims data whereby the claimed amounts were applied to the litigation tort payout rate and averaged for 5 years of data. As of September 30, 2020, the USN GF has a potential loss of approximately $7.7 million from administrative tort claims.

Legal Contingencies:

The USN GF is a party to various administrative proceedings, legal actions, and claims for environmental damage, employment matters, tort damages and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The OGC and OJAG conduct reviews of litigation claims involving the USN GF to which the OGC and OJAG attorneys devoted substantial attention in the form of legal consultation or representation. The OGC and OJAG assess the likelihood of an unfavorable outcome as follows: probable, reasonably possible, or remote.

Probable Likelihood of an Adverse Outcome:

As of September 30, 2020, the USN GF has an estimated potential loss of $45.5 million that is assessed as probable if adverse decisions are made against the Navy. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is probable that an adverse outcome will result. The potential loss is reported as part of the Other Liabilities on the Balance Sheet. For certain claims that are paid by Treasury's Judgment Fund, which Navy does not have to reimburse, an Imputed Financing Source is recognized. However, agencies are required to reimburse the Judgment Fund for payments pursuant to the Contract Disputes Act and the Notification and Federal Employees Antidiscrimination and Retaliation Act of 2002.

Refer to Note 13, "Other Liabilities," for additional information.

Reasonably Possible Likelihood of an Adverse Outcome:

As of September 30, 2020, the USN GF has an estimated potential loss of $265.2 million that is assessed as reasonably possible if adverse decisions are made against the USN GF. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is reasonably possible that an adverse outcome will result.

The United States and by extension the Department of the Navy, is party to certain international court matters that remain undecided at the time of this report. Some of these matters, if decided against the United States and by extension the Department of the Navy, may result in an outflow of resources material to the financial statements. As of September 30, 2020, these matters are not probable, quantifiable, or certain to occur; therefore, no liability is estimated or included in this note.

NOTE 16. FUNDS FROM DEDICATED COLLECTIONS

As of September 30 ($ in thousands)	Unaudited 2020
Balance Sheet	
Assets	
Intragovermental:	
Fund Balance with Treasury	$ 53,490
Investments	5,071
Total Assets	**58,561**
Liabilities	
Other Liabilities	379
Total Liabilities	**379**
Cumulative Results of Operations	58,182
Total Liabilities & Net Position	**$ 58,561**
Statement of Net Cost	
Program Costs	25,758
Less: Earned Revenue	(163)
Net Cost of Operations	**25,595**
Statement of Changes in Net Position	
Net Position, Beginning of the Period	54,553
Net Cost of Operations	(25,595)
Budgetary Financing Sources Other Financing Sources	29,224
Change in Net Position	3,629
Net Position End of Period	**$ 58,182**

The USN GF currently has four funds from dedicated collections: Wildlife Conservation, the DON General Gift, Ship Stores Profit, and the U.S. Naval Academy General Gift fund.

The Wildlife Conservation Fund is a special fund authorized by 16 USC 670b, and provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for these programs at USN GF installations charging such user fees. These programs are carried out through cooperative plans agreed upon by the local representatives of the SECDEF, the Secretary of the Interior, and the appropriate agency of the state in which the installation is located.

The DON General Gift Fund is authorized by 10 USC 2601. Under the provisions of this statute, the SECNAV may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that it be used for the benefit, or in connection with the establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of USN GF.

The Ships Stores Profit Fund is authorized by 10 USC 7220. Deposits to this fund are derived from profits realized through the operation of ships' stores and from gifts accepted for providing recreation, amusement, and contentment for enlisted members of the Navy and Marine Corps.

The U.S. Naval Academy General Gift Fund is authorized by 10 USC 6973. Under the provisions of this statute, SECNAV may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it be used for the benefit of, or in connection with, the United States Naval Academy, or the Naval Academy Museum, its collections, or its service.

FINANCIAL SECTION US NAVY GENERAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

NOTE 17. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Cost and Exchange Revenue

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Costs	$ 45,631,725
Non-federal Costs	112,591,116
Total Cost	**158,222,841**
Intragovernmental Revenue	(2,654,408)
Non-federal Revenue	(856,156)
Total Revenue	**(3,510,564)**
Total Net Cost	**$ 154,712,277**

The SNC represents the net cost of programs and organizations of the USN GF. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The USN GF's current processes and systems capture costs based on appropriations groups and not major programs in accordance GPRA, due to system and business process limitations. The USN GF is in the process of reviewing available data and developing a cost reporting methodology to comply with the standard.

Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by USN GF are recognized as imputed cost in the SNC and are offset by imputed revenue in the SCNP. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgement Fund. However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

Sailors prepare to load Encapsulated Harpoon Certification Training Vehicles (EHCTV) onto the submarine. (U.S. Navy photo by Mass Communication Specialist 2nd Class Justin R. Pacheco/Released)

NOTE 18. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources (SBR) is presented on a combined basis in accordance with Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements (OMB A-136); thus, intra-entity transactions have not been eliminated from the amounts presented.

UNDELIVERED ORDERS AT THE END OF THE PERIOD

As outlined in OMB A-136, undelivered orders are to be presented as intragovernmental and non-federal. For FY 2020, the USN GF adopted a methodology to estimate intragovernmental and non-federal undelivered orders based on the total federal and non-federal designation for Accounts Payable, prepaid advances and prepayments.

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental:	
Unpaid	$ 17,775,463
Prepaid/Advanced	1,576,186
Total Intragovernmental	**19,351,649**
Non-Federal:	
Unpaid	121,871,176
Prepaid/Advanced	521,600
Total Non-Federal	**122,392,776**
Total Budgetary Resources Obligated for Undelivered Orders at the End of the Period	**$ 141,744,425**

PERMANENT, INDEFINITE APPROPRIATIONS

The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of DoD sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the U.S. and documented under the laws of the U.S.; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet, including the acquisition, alteration or conversion of vessels. There were no transfers in or out of NDSF during the fiscal year.

The Environmental Restoration, Navy (ER,N) appropriation is a transfer account that funds environmental restoration, reduction, and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds remain available until transferred and remain available for the same purpose and same time period as the appropriations to which transferred. As of September 30, 2020 reporting, there were four transfers from ER,N for $385.0 million to the Operation and Maintenance, Navy and Other Procurement, Navy appropriations. Appropriations Received on the SCNP does not agree with Appropriations Received on the SBR due to differences between proprietary and budgetary accounting concepts and reporting requirements.

EXPLANATION OF DIFFERENCES BETWEEN THE COMBINED STATEMENT OF BUDGETARY RESOURCES AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The Statement of Budgetary Resources has been prepared to agree with the amounts shown in the Budget of the United States Government. The Budget of the United States Government containing the actual amounts for FY 2020 has not been published at the time these financial statements were prepared. The FY 2021 Budget of the United States Government with the actual FY 2019 amounts was released in February 2020. The FY 2022 Budget of the United States Government with the actual amounts for the current year (FY 2020) will be available at a later date on OMB website at https://www.whitehouse.gov/omb/budget/.

The table below presents the FY 2019 differences between the amounts reported in the FY 2019 SBR and the actual FY 2019 amounts reported in the FY 2021 Budget of the U.S. Government for SBR lines Total Budgetary Resources; New Obligations and Upward Adjustments; Outlays, Net; and Distributed Offsetting (Receipts)/Outlays, Net.

As of September 30 ($ in billions)	Fiscal Year 2019 Actual			
	Total Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Net Agency Outlays
FY 2019 Combined Statement of Budgetary Resources	$ 223.2	$ 180.5	$ —	$ 153.9
Reconciling Items:				
USMC GF activity not presented in the Combined Statement of Budgetary Resources	22.8	21.9	—	27.2
Per FY2021 Budget of the US Government	**$ 246.0**	**$ 202.4**	**$ —**	**$ 181.1**

Gunner's Mate Seaman operates the EP2 panel aboard the Arleigh Burke-class guided-missile destroyer USS Russell (DDG 59). (U.S. Navy photo by Mass Communication Specialist 3rd Class Sean Lynch/Released)

NOTE 19. FIDUCIARY ACTIVITIES

SCHEDULE OF FIDUCIARY ACTIVITY

As of September 30 ($ in thousands)	Unaudited 2020
Fiduciary Net Assets, Beginning of Year	$ 58,513
Reclassifications	821,595
Contributions	408,997
Disbursements To and On Behalf of Beneficiaries	(323,321)
Increase/(Decrease) in Fiduciary Net Assets	907,271
Fiduciary Net Assets, End of Period	**$ 965,784**

SCHEDULE OF FIDUCIARY NET ASSETS

As of September 30 ($ in thousands)	Unaudited 2020
Fiduciary Assets	
Fund Balance with Treasury	$ 965,784
Total Fiduciary Net Assets	**$ 965,784**

The USN GF fiduciary activity consists of funds in the Savings Deposit Program and Foreign Cooperative Agreements. Service members of the USN GF who are on a permanent duty assignment outside the U.S. or its territories can earn interest at a rate prescribed by the President, not to exceed 10% per year, on up to $10 thousand deposited into the program. This limitation shall not apply to deposits made on or after September 1, 1966, in the case of those members in a missing status during the Vietnam conflict, the Persian Gulf conflict, or a contingency operation. In accordance with 22 USC 2767, the President may enter into a cooperative project agreement with the North Atlantic Treaty Organization or with one or more member countries of that Organization. These agreements are made in an effort to leverage share of costs, contracts and other resources where shared interests exist. The USN currently has four (4) BSOs operating within foreign cooperative agreements: NAVAIR, NAVWAR, NAVSEA, and ONR.

In first quarter of Fiscal Year 2020, the classification of deposit account 17x6502 (Foreign Cooperative Agreement) was reclassified from non-fiduciary to fiduciary. The “Fiduciary Net Assets, Beginning of Year” balance within the “Schedule of Fiduciary Activity” in Note 19 above includes the beginning balance of this deposit account (17x6502) in the amount of $821.6 million.

THIS PAGE INTENTIONALLY LEFT BLANK

NOTE 20. RECONCILIATION OF NET COST TO NET OUTLAYS

As of September 30 ($ in thousands)	Unaudited 2020		
	Intragovernmental	With the public	Total
Net Cost of Operations (SNC)	$ 42,977,317	$ 111,734,960	$ 154,712,277
Components of Net Cost That are Not Part of Net Outlays:			
Property, Plant, and Equipment Depreciation	—	(42,936,657)	(42,936,657)
Property, Plant, and Equipment Disposal & Revaluation	—	1,785,052	1,785,052
Other	(7,564)	8,963,968	8,956,404
Increase/(Decrease) in Assets:			
Account Receivable	24,629	(94,046)	(69,417)
Other Assets	158,630	338,089	496,719
(Increase)/Decrease in Liabilities:			
Accounts Payable	383,125	(1,223,473)	(840,348)
Salaries and Benefits	(39,573)	(97,780)	(137,353)
Environmental and Disposal Liabilities	—	326,493	326,493
Other Liabilities (Unfunded Leave, Unfunded FECA, Actuarial FECA)	(38,350)	864,786	826,436
Other Financing Sources:			
Federal Employee Retirement Benefit Costs Paid by OPM And Imputed to the Agency	(629,800)	—	(629,800)
Transfers out (in) without reimbursement	(3,307,716)	—	(3,307,716)
Other imputed financing	(50,939)		(50,939)
Total Components of Net Cost That Are Not Part of Net Outlays	**(3,507,558)**	**(32,073,568)**	**(35,581,126)**
Components of Net Outlays That Are Not Part of Net Cost:			
Acquisition of Capital Assets	—	43,546,623	43,546,623
Acquisition of Inventory	7,564	2,694,580	2,702,144
Other	(39,787)	(29,248)	(69,035)
Total Components of Net Outlays That Are Not Part of Net Cost	**(32,223)**	**46,211,955**	**46,179,732**
Net Outlays	$ 39,437,536	$ 125,873,347	$ 165,310,883
Agency Outlays, Net, Statement of Budgetary Resources			$ 165,310,883
Reconciling Difference			—

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position, so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis above illustrates this reconciliation by listing the key differences between net cost and net outlays.

The U.S. Navy Flight Demonstration Squadron, the Blue Angels honored frontline COVID-19 first responders and essential workers. (U.S. Navy photo by Lt j.g. Chelsea Dietlin/Released)

NOTE 21. PUBLIC-PRIVATE PARTNERSHIPS

Background

Congress established the Military Housing Privatization Initiative (MHPI) in 1996 as an alternative method to help the military improve the quality of life for its military members. By using the expertise and tools afforded to private companies Navy military housing improvements occurred more expediently and efficiently than the traditional military construction process would allow. 10 U.S.C. §§ 2871-2886 codified the Service Secretaries' MHPI authority, as modified by Pub. L. 116-62, Title XXX – Military Housing Privatization Reform.

The Secretary of the Navy (SECNAV) delegated MHPI authority to the Naval Facilities Engineering Command (NAVFAC), and authorized NAVFAC to enter into agreements with eligible entities from the private sector on behalf of the Navy. NAVFAC selected Partners through a competitive process with the intent to demolish, construct, renovate, maintain, and operate family housing and unaccompanied housing for the Navy.

The Navy possesses the following authorities to assist in the execution of Public Private Partnerships (P3s): direct loans and loan guarantees (10 U.S.C. § 2873), rental guarantees (10 U.S.C. § 2876), differential lease payments (10 U.S.C. § 2877), contributions (10 U.S.C. §§ 2875 and 2883), and the conveyance or leasing of land, housing, and other facilities (10 U.S.C. §§ 2875 and 2878). Based on these authorities and after careful analysis and consideration, the Navy elected to enter MHPI P3s by providing appropriated funds to the Department of Defense (DoD) MHPI program. Navy conveyed real property assets to the selected private partners, entering into long-term leases of the underlying land, contributing cash to the selected partners from the Family Housing Improvement Fund (FHIF) and using direct loans from the DoD FHIF.

Detailed reports to the appropriate committees of Congress on the MHPI projects are required by 10 U.S.C. § 2884 for each project, conveyance, or lease proposed; as a part of the annual budget submission; and as an annual report concerning the status of oversight and accountability. Additionally, the House Report 116-63, Page 11, accompanying H.R. 2745, the Department of Defense Appropriations Bill, 2020, directs the Service Secretaries to submit a report to the congressional defense committees detailing: (1) how the Services monitor privatized facilities at a national level and (2) any planned upgrades to this system to improve transparency.

The expected life of each MHPI arrangement corresponds to the duration of the ground lease (generally 50 years). The bulk of Navy arrangements will complete the initial term in the 2050-2056 timeframe. Negotiations between the Navy and the private partners established the duration of the ground lease based on the minimum duration required to ensure project success.

The complete universe of Navy family and unaccompanied housing MHPI arrangements is as follows:

The Navy has two (2) MHPI family housing arrangements comprised of one (1) project each under the 10 U.S.C. § 2837 authority which are no longer extant:
- Kingsville I
- Everett I

The Navy has one (1) MHPI family housing arrangement comprised of one (1) project under 10 U.S.C. §§ 2871-2886 authorities which is no longer extant:
- Everett II

The Navy has ten (10) MHPI family housing arrangements with twelve (12) partners under 10 U.S.C. §§ 2871-2886 authorities that continue in operation:
- Kingsville II
- San Diego

- New Orleans
- South Texas
- Hawaii
- Northeast
- Northwest
- Mid-Atlantic
- Midwest
- Southeast

The Navy has two (2) Military Unaccompanied Housing arrangements with two (2) partners under 10 U.S.C. §§ 2871-2886 authorities that continue in operation:
- Hampton Roads Unaccompanied Housing
- San Diego Unaccompanied Housing (Pacific Beacon)

Note: *As required by the legal agreements between the Navy and its MHPI partners, in order to protect the business sensitive information contained within those individual arrangements, the Navy has elected to aggregate the financial information herein. In cases where data from a single MHPI is presented, that information is presented without naming the specific entity involved.*

Responsibilities

The Non-government Managing Member (also referred to as the Partner) is responsible for the management of the MHPI entity with the goal of providing adequate housing to Navy military members choosing to reside in these facilities for rents set equal to the area housing allowance. In the FY2020 NDAA, Pub. L. 116-62, Title XXX – Military Housing Privatization Reform, Congress provided notional standards and definitions for adequate housing (services' condition assessments shall utilize private sector housing industry construction codes and sizing standards as a basis for assessing inventory adequacy), and initiated the process to establish tenant rights and responsibilities for all DoD MHPI housing. In general, the MHPI entities are to provide services, which include the management, maintenance, and operations of the facilities over the life of the operating agreement. The Partner has sole and exclusive management and control over the MHPI entity. The Navy will not take part in the day-to-day management of the MHPI, however to protect its interests in certain specific circumstances the Navy has reserved the ability to concur/approve with the Managing Member's decisions/ recommendations (i.e., annual operating budgets, recapitalization plans, incurring additional debt).

Funding

Contributions from the DoD MHPI program and the Partner typically occur at the beginning of any new project, and occur as a pre-condition of follow on phases as required by the Operating Agreement (OA). During Phase I, the initial development phase, the Navy entered into long term ground leases (generally 50 years) and conveyed the then existing associated real property assets (buildings, structures, facilities, and utilities) to the MHPI P3, organized as a Limited Liability Company (LLC) or Limited Partnership (LP). The Navy provided a nominal amount of funding to DoD Family Housing Improvement Fund (FHIF) or DoD Military Unaccompanied Housing Improvement Fund (MUHIF). Once the Navy funds were in the FHIF, the DoD MHPI program made direct cash contributions and loans to the LLCs/LPs at Navy's request.

Cash contributions to MHPI P3 partners from the DoD FHIF or DoD MUHIF requires Congressional notification (10 U.S.C. § 2883(f)). There are no contractual requirements for additional federal contributions to the LLCs/LPs. The Navy has not made any in kind contributions/services or donations to the MHPI entities.

The Navy is not required to contribute resources to the MHPI P3 beyond the initial contribution, and any subsequent contributions required as a pre-condition to follow on phases, to the FHIF or MUHIF and has not made any such additional capital contributions, loans or loan guarantees to the MHPI P3s.

The limited cash contributions of the Navy at formation were used by the Managing Members to fund start-up costs and initial working capital of the MHPI. A substantial portion of the buildings contributed to the MHPI were demolished or substantially renovated shortly after the projects were formed. The capital necessary to construct or renovate the projects came from the issuance of third-party debt collateralized solely by the projects themselves. Funds to support the operations of the MHPI P3s comes from the rental revenue received from the tenants. The Navy does not guarantee any debts incurred by the MHPI entity.

Military Members, as part of their compensation receive a Basic Allowance for Housing (BAH). BAH is determined by Congress as the market cost of housing for each applicable geographic region as calculated under section 403(b)(3)(A)(i) of the military pay statute in Title 37, U.S.C. It is authorized through the National Defense Authorization Act (NDAA) and appropriated via the Defense Appropriations Act (or Continuing Resolutions) annually. If the Military Member uses MHPI, the associated BAH amount is considered to be an indirect third-party payment from Navy as discussed in SFFAS 49, para 24.c.i.3 and as disclosed below.

Beginning in 2018 Congress enacted several laws to make up for BAH reductions in prior years. These laws require the Navy to supplement the housing allowances of the service members residing in the facilities by making direct payments to the MHPI entities. These direct payments are described and disclosed below:

- From 01 January – 31 December 2018, Pub L. 115-91 § 603 directed that payments to the MHPI entities of 1% of the amount of BAH calculated under section 403(b)(3)(A)(i) of the military pay statute in Title 37, U.S.C. for the area in which the covered housing existed would be made monthly.
- From 01 September 2018 to 31 December 2019, Pub. L.115-232 § 606 directed that payments to the MHPI entities of 5% of BAH as calculated as described above would be made monthly.
- From 01 January 2020 forward, Pub. L.116-92 §§ 3036 and 3037 directs that payments to the MHPI entities of 2.5% of BAH as calculated as described above will occur monthly for all MHPI entities. Additionally, "underfunded" projects may receive up to an additional 2.5% of BAH monthly at the determination of the Chief Housing Officer of the Department of Defense and SECNAV until Congress modifies or rescinds this direction. (Note: The Chief Housing Officer of the Department of Defense promulgated interim guidance for Pub. L. 116-92 §§ 3036 and 3037 on 10 June 2020. The DON has issued implementing guidance for the Navy, and the Navy began Pub. L. 116-92 §§ 3036 and 3037 payments in Q4 FY2020.)

The following table represents the current fiscal year Navy transactions in support of the MHPI Program and LLCs/LPs through 30 September 2020:

FY 2020 Navy Transactions for the year ended September 30, 2020 ($TYM)	
Navy cash transfers to DoD FHIF/MUHIF	$ 0.00
Real property contributions to the MHPI LLCs/LPs (value of Real Property Assets (RPA) conveyed, per MHPI audited financial statements)	$ 0.09
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1) (actuals) (Note 1)	$ 41.49
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(2 (actuals) (Note 2)	$ 2.68
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(3) (actuals (Note 3)	$ 0.00
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1),(a)(2), and (a)(3) (current liability for invoices received as of 30 September 2020 but not yet paid) (Note 4)	$ 34.29
Navy indirect third party payments to MHPI LLCs/LPs in FY2020 (Notes 5 and 6)	$ 968.22

Note 1: *Pub. L. 115-91 § 603 and Pub. L. 115-232 § 606 (a)(1).*
Note 2: *Pub. L. 115-232 § 606 (a)(2) (as established by Pub. L. 116-92 §§ 3036 and 3037)*
Note 3: *Pub. L. 115-232 § 606 (a)(3) (as established by Pub. L. 116-92 §§ 3036 and 3037)*
Note 4: *Pub. L. 115-91 § 603 and Pub. L. 115-232 § 606 (a)(1)(a)(2), and (a)(3) (as established by Pub. L. 116-92 §§ 3036 and 3037)*
Note 5: *BAH provided under section 403 of title 37 to Military Members living in privatized housing.*
Note 6: *The number of military family housing units upon which these estimated payments were made is 31,636 in FY 2020. The number of units of military unaccompanied housing upon which these estimated payments were made is 5,887 in FY 2020.*

The following table represents the cumulative Navy transactions in support of the MHPI Program and LLCs/LPs through 30 September 2020:

Cumulative Navy Transactions through September 30, 2020 ($TYM)	
Navy cash transfers to DoD FHIF/MUHIF (Notes 7 and 8)	$ 360.16
Real property contributions to the MHPI LLCs/LPs (value of Real Property Assets (RPA) conveyed, per OMB scoring documents)	$ 2,170.57
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1) (actuals) (Note 1)	$ 57.75
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(2 (actuals) (Note 2)	$ 2.68
Navy direct payments to MHPI LLCs/LPs as required by § 606 (a)(3) (actuals (Note 3)	$ 0.00
Navy direct payments to MHPI LLCs/LPs as required by § 603 and § 606 (a)(1),(a)(2), and (a)(3) (current liability for invoices received as of 30 September 2020 but not yet paid) (Notes 4 and 9)	$ 39.40
Navy indirect third party payments (BAH provided under section 403 of title 37 to members living in privatized housing) to MHPI LLCs/LPs (Notes 10 and 11)	UNK

Note 7: *The Navy funding transfers were amounts necessary to establish the program or correct shortfalls in commitments to have housing allowances reflect local market conditions and are not expected to be recovered by the Navy. The real property contributions similarly were fully depreciated or are expected to be fully depreciated over the life of the arrangements and are not expected to have a material book value upon their return at the end of the land lease. Accordingly, no amounts are reflected in the FY2020 Navy General Fund Balance Sheet for the assets transferred to the MHPI P3s.*
Note 8: *Additional Navy review of financial transactions for the period FY1996-2019 revealed that the total of Navy funds transferred to the DoD FHIF/MUHIF was $360.2M instead of the total reported in the Navy FY2019 Financial Statement of $124.9M.*
Note 9: *As provided in SFFAS 49, para 24.b, any potential future payments beyond the current liabilities reflected above are not estimable and are therefore not provided. This is due to there being no contractual requirement to make additional payments and the uncertainty associated with Congressional action in this area over the last two years, and the projected revision to the DoD policy governing Section 606(a)(2) and (3) payment authorizations in FY2021.*
Note 10: *As provided in SFFAS 49, para 24.b, the cumulative BAH amounts are not readily available nor supportable, therefore no estimate of the cumulative amount of BAH is provided. This disclosure requirement did not exist until FY2019, and Navy has no way of recreating or estimating BAH payments made to individuals living in MHPI housing from program inception in FY1996 through FY2018. Navy will report annual BAH amounts as a part of this disclosure on a go forward basis.*
Note 11: *As provided in SFFAS 49, para 24.b, Navy does not estimate the future amount of BAH to be paid to MHPI entities. This is due to the uncertainties associated with the number of members residing in MHPI housing year over year, the paygrade mix of members residing in MHPI housing, and the potential changes in the BAH rates which occur in the annual National Defense Authorization Acts (NDAAs) and which are implemented through annual appropriations to the Navy. Further, it is a discretionary choice on the part of individual Service Members to live in MHPI housing. Service Members may choose to spend their BAH in MHPI housing, non-MHPI housing, or purchase housing. There is no commitment or guarantee on the part of the Navy to any MHPI entity to ensure a minimum number of military residents in MHPI housing.*

The following table represents the current year DoD transactions in support of the Navy MHPI Program and LLCs/LPs through 30 September 2020:

FY20 DoD Transactions for the year ended September 30, 2020 ($TYM) (Note 12)	
DoD cash disbursements from the FHIF/MUHIF to MHPI LLCs/LPs	$ 0.00
DoD government direct loans from the FHIF to MHPI LLCs/LPs	$ 0.00

The following table represents the cumulative DoD transactions in support of the Navy MHPI Program and LLCs/LPs through 30 September 2020:

Cumulative DoD Transactions through 30 September 2020 ($TYM) (Note 12)	
DoD cash disbursements from the FHIF/MUHIF to MHPI LLCs/LPs	$ 357.65
DoD government direct loans from the FHIF to MHPI LLCs/LPs	$ 2.50

Note 12: *The financial amounts represented above are presented in the DoD's consolidated financial statement and their respective note disclosures and are not presented within the Navy's financial statements.*

Neither the Navy nor the DoD have made or expect to make any additional cash contributions, loans, or conveyance of real property to the LLCs/LPs after October 01, 2020 through the end of the P3 arrangements.

The following table represents the current year MHPI Managing Member (Private Partner) contributions to the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported during the year ended 30 September 2020:

FY20 MHPI Managing Member Contributions to the MHPI LLC/LP for the year ended September 30, 2020 ($TYM)	
Cash contribution to MHPI LLCs/LPs by Managing Member	$ 0.00
Value of real property and land contributed to MHPI LLCs/LPs by Managing Member	$ 0.00

The following table represents the current year transactions of the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported during the year ended 30 September 2020:

FY20 MHPI LLC/LP Transactions for the year ended September 30, 2020 ($TYM)	
Bonds or construction loans obtained by MHPI LLCs/LPs	$ 0.00
Value of real property assets donated to Navy by MHPI LLC/LP	$ 0.00
Cash transferred to Navy by MHPI LLC/LLP	$ 0.00
Govt Direct Loan repayments made by the MHPI LLCs/LPs to DFAS in FY2020	$ 0.13

The following table represents the cumulative MHPI Managing Member (Private Partner) contributions to the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported during the year ended 30 September 2020:

Cumulative MHPI Managing Member Contributions to MHPI LLC/LP through September 30, 2020 ($TYM)	
Cash contribution to MHPI LLCs/LPs by Managing Member	$ 65.29
Value of real property and land contributed to MHPI LLCs/LPs by Managing Member	$ 0.33

The following table represents the current year transactions of the MHPI LLC/LP as reported on the books of the MHPI during the entity's fiscal year and reported during the year ended September 30, 2020:

Cumulative MHPI LLC/LP Transactions through September 30, 2020 ($TYM)	
Bonds or construction loans by MHPI LLCs/LPs balance outstanding	$ 3,958.95
Value of real property assets donated to Navy by MHPI LLC/LP since 2019 (Note 13)	$ 51.73
Cash transferred to Navy by MHPI LLC/LLP	$ 0.00
Govt Direct Loan Outstanding Balance	$ 1.50
Govt Direct Loan repayments made by the MHPI LLCs/LPs through 30 September 2020 (Note 14)	$ 1.00

Note 13: In 2019, one MHPI entity returned to Navy unimproved and unused assets which Navy had previously conveyed to the MHPI entity. The assets were valued at PRV and the valuation will be adjusted as Navy reviews its asset valuation policy and or accounting practices related to real property.
Note 14: *Final loan repayment due May 2032.*

There is no requirement for the Private Partners to make any additional contributions after 01 October 2020 through the end of the arrangements (approx. through 2050).

The MHPI entities have not borrowed or invested capital based on the Navy's promise to pay, either implied or explicit.

Risk of Loss and Expectation of Gain

The DoD's risk of loss is the initial cash contribution to the program; the Navy's risk is failure to deliver quality-housing services to Navy Military Personnel. The private partner's risk of loss includes the recovery of the initial cash contributions, inability to repay bonds and/or loans, and the loss of a long-term revenue source. Each MHPI Operating Agreement prescribes revenue flow "waterfall" during the life of the arrangement and upon liquidation of the arrangement. These waterfalls generally allow the managing Partner an opportunity to earn incentives and returns for economic performance after providing a set aside of capital for the maintenance of the facilities. Should monies exist in excess of the required reserves securing or repaying the debt, the required reserves for maintenance of the facilities, and the contractual incentive payments to the managing Partner, the excess would be returned to the FHIF at entity dissolution.

The MHPI Operating Agreements do not explicitly identify risk of loss contingencies.

The MHPI entity cash flow is dependent on Congressional authorization and appropriation of basic allowance for housing, which becomes a third party payment for rent to the MHPI entity. The Navy can influence but cannot control the authorization and appropriation process. Additionally, because of ongoing congressional review of the MHPI program, there may be changes to the relationship between the Navy and the entity based on Congressional action. If or when action is taken, the Navy will disclose any financial changes or impacts that this may pose/cause. This is potentially a remote impact that is not measurable at this time. Conversely, there is an expectation that the market based rent to be received by the MHPI P3s will be sufficient to cover operating expenses, debt service, and remuneration of the Managing Partner and any excess return is retained within the individual MHPI entity long-term recapitalization/operational reserve lockbox accounts for future use by the entity.

Risk of Termination or Non-Compliance

As noted above, Navy does bear risk in the form of non-performance in that, in some cases failure of an MHPI P3 could leave it with inadequate housing alternatives for its military members. There is no requirement in any of the arrangements for the Navy to repay loans or other obligations of the MHPI P3s. In addition to the ability to dispose of assets not subject to the land leases and the ability to refinance or seek additional debt, the arrangements allow for protections for the lenders and the Navy by allowing the removal of property managers for non-performance. As of this note, from inception to date neither the lenders nor Navy has exercised the right to request removal of property managers or other affiliated parties.

During 2020, one of the MHPI P3s was determined to be in financial distress. In their 2019 financial statement audit, the independent public accountant (IPA) identified going concern issues, and the entity completed remedial actions in June 2020. As of the date of this report, the distressed MHPI P3 is being restructured with negotiations expected to finalize not later than 31 October 2020. In some instances, including the distressed MHPI P3, the Navy provides utility services at cost to the housing area operated by the LLC/LP. The LLC/LP is contractually required to provide reimbursements for utility services provided by the Navy and in the case of the distressed MHPI P3, an additional risk existed in the form of non-payment of utility reimbursement in arrears. However, following the remediation actions, a partial payment to Defense Finance Accounting Service (DFAS) has been made with the full balance being paid upon restructure closing. The restructure and DFAS payment were completed without Navy intervention and without either additional Navy or DoD funding or guarantees.

There are no additional contractual or other risks of loss to the private entities, or any expected risks to cash flows known at this time.

Other Arrangements

The Navy conducted a review of agreements, which may have on the surface, resembled a Public Private Venture (PPV)/P3. This review encompassed Enhanced Use Leases, Renewable Energy Program Out-leases, Utility Energy Savings Contracts, Power Purchase Agreements, Privatized Utilities, and Energy Savings Performance Contracts. Our analysis supports that these contracts and agreements do not constitute a PPV/P3 and do not require disclosure under SFFAS 47 or SFFAS 49.

NOTE 22. DISCLOSURE ENTITIES AND RELATED PARTIES

The USN GF has relationships which constitute control for NAFIs and FFRDCs as these entities meet the SFFAS 47 "Reporting Entity" control principle regarding risk of loss or expectation of benefits.

The USN GF maintains long-term contractual relationships with the parent organizations of Foreign Military Financing, Special Defense Acquisition Fund, Foreign Military Loan Liquidating Account, Military Debt Reduction Financing Account, Advances, and Foreign Military Sales, Security Assistance programs, the U.S. Forest Service, and the Federal Highway Administration. The USN GF sponsored FFRDCs to meet research or development needs that cannot be met as effectively by existing government or contractor resources. The FFRDCs provide research and development laboratory centers to support the USN. All USN GF funding for FFRDCs work is provided through the Department's contract with the parent organization that operates each FFRDC. FAR Part 35.017 provides federal policy for the establishment and use of FFRDCs.

The USN FFRDC relationships are defined through bi-lateral sponsoring agreement between each USN sponsoring organization and the university or private-sector nonprofit parent organization that operates each FFRDC. While the USN does not control the FFRDCs, the parent organization must agree that the FFRDC will conduct its business in a manner befitting its special relationship with the USN GF, operate in the public interest with objectivity and independence, and be free from organizational conflicts of interest. An FFRDC may be used only for work that is within its purpose, mission, and general scope of effort, as established in the sponsoring agreement.

The USN receives significant benefits from the work of the FFRDCs, which is critical to national security. Congress restricts the amount of support that the Department may receive from USN sponsored FFRDCs through a limitation that it sets annually on the staff years of technical effort that be funded.

The USN GF's NAFIs are fiscal entities supported in whole or in part by NAFs. For the most part, NAFs are generated from sales and user fees. The USN GF's NAFIs are established by DoD policy, and are Morale, Welfare, and Recreation (MWR) entities, intended to enhance the quality of life of members of the uniformed services, retired members, and dependents of such members, and to support military readiness, recruitments, and retention.

The Under Secretary of Defense for Personnel and Readiness (USD(P&R)) exercises overall policy direction for oversight of USN GF NAF activities. The Under Secretary of Defense (Comptroller) and Chief Financial Officer and the DFAS, in coordination with the USD(P&R), are responsible for NAF accounting policy. DoD policy requires the USN to appoint advisory groups for NAFIs. The advisory group ensures the NAFI is responsive to authorized patrons and to the purposes for which the NAFI was created. Additionally, the NAFIs are subject to USN policy requirements for financial reporting to USD(P&R) and financial audits conducted by independent public accounting firms. However, NAFI financial activity is not included in the USN GF financial statements.

Refer to Note 21, "Public-Private Partnerships" for USN GF's PPV/P3s that were identified for disclosure in compliance with SFFAS 47 and SFFAS 49.

NOTE 23. COVID-19 ACTIVITY

On March 13, 2020 the United Stated declared a national emergency concerning the COVID-19 Outbreak. Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R 748-240/Public Law 116-136) to respond to the COVID-19 outbreak and its impact on the economy, public health, state and local governments, individuals, and businesses. USN GF subsequently received $360.3 million in funding related to the CARES Act beginning in Q2 FY 2020. As of Q4 FY 2020, USN GF also received transfer authority of $545.9 million for Operations & Maintenance (O&M) (APPN 1804), $10.8 million for Other Procurement - Navy (1810), $6.3 million for O&M, Reserve (APPN 1806) and $3.0 million for Military Personnel (APPN 1453). As of Q4 FY 2020, $807.3 million has been obligated related to the CARES Act. Remaining unobligated budgetary resources (allotments and commitments) for the CARES Act total $119.0 million. Of this amount, $10.8 million (APPN 1810) remains open for new obligations. The remaining $108.2 million unobligated balance can be used for upward/downward adjustments of prior obligations until those funds cancel.

Due to system limitations, the USN GF does not currently report proprietary accounting transactions related to COVID-19 activity and differences exist between reporting of COVID-19 supplemental funding within this disclosure and external budget execution reporting.

COVID 19 SUMMARY ($ in Millions)	Unaudited 2020				
TAS - Description	Appropriations Received	Net Transfers	Unpaid Obligations	Paid Obligations	Unobligated Balance
1804 – Operations and Maintenance, Navy	$ 360.3	$ 545.9	$ 415.9	$ 386.8	$ 103.5
1810 – Other Procurement, Navy	—	10.8	—	—	10.8
1806 – Operations and Maintenance, Reserve	—	6.3	2.3	1.7	2.3
1453 – Military Personnel	—	3.0	—	0.6	2.4
Unaudited 2020	—	—	—	—	—
Total	**$ 360.3**	**$ 566.0**	**$ 418.2**	**$ 389.1**	**$ 119.0**

NOTE 24. SUBSEQUENT EVENTS

On July 12, 2020, a fire destroyed the USS Bonhomme Richard (LHD-6) that was acquired in 1998 with an acquisition cost of $1.2 billion. The net book value as of July 12, 2020 was $542.0 million. On November 30, 2020, the Navy announced in a press release that it decided to decommission and scrap the USS Bonhomme Richard, instead of repairing it. The loss on the ship will be recognized in FY 2021.

The aircraft carrier USS Nimitz (CVN 68) goes alongside the fleet replenishment oiler USNS Henry J. Kaiser (T-AO 187) for a replenishment-at-sea. (U.S. Navy photo by Mass Communication Specialist 3rd Class Sarah Christoph/Released)

UNITED STATES NAVY GENERAL FUND

REQUIRED SUPPLEMENTARY INFORMATION

This section provides the Required Supplementary Information to accompany the basic financial statements as prescribed by accounting standards.

Deferred Maintenance and Repair

USN GF conducts large quantity of Equipment Maintenance and Repair that encompasses several assets across the Navy. Aircraft and Ships, considered among the most high-tech in the world, constitute major categories for the Navy's Deferred Maintenance and Repair (DM&R).

Disaggregated Statement of Budgetary Resources

The Combined Statement of Budgetary Resources combines the availability, status, and outlays of USN GF budgetary resources. The Statement of Disaggregated Budgetary Resources provides the Combined Statement of Budgetary Resources disaggregated by USN GF programs for the fiscal year ended September 30, 2020.

GENERAL PROPERTY, PLANT, AND EQUIPMENT REAL PROPERTY DEFERRED MAINTENANCE AND REPAIR

For the Fiscal Year Ended September 30, 2020

($ in millions)

Property Type	Unaudited 2020		
	1. Plant Replacement Value	2. Required Work (Deferred Maintenance and Repair)	3. Percentage
ACTIVE			
Category 1: Enduring Facilities			
Navy (Less: Military Family Housing)	$ 234,571	$ 15,342	6.54%
Military Family Housing	7,706	1,240	16.09%
Category 2: Heritage Assets			
Navy (Less: Military Family Housing)	–	–	–
Military Family Housing	–	–	–
INACTIVE			
Category 3: Excess Facilities or Planned for Replacement			
Navy (Less: Military Family Housing)	$ 6,125	$ 405	6.61%
Military Family Housing	168	98	58.33%

Note: *In the table above, Navy real property deferred maintenance and repair data represent both USN GF and Change to DON WCF.*

General Property, Plant and Equipment

Description of Property Categories:

Category 1 – Buildings, Structures, and Linear Structures that are enduring and required to support an ongoing mission, including multi-use Heritage Assets

Category 2 – Buildings, Structures, and Linear Structures that are Heritage Assets

Category 3 – Buildings, Structures, and Linear Structures that are excess to requirements or planned for replacement or disposal, including Heritage Assets

Description of Property Types:

Building: A roofed and floored facility enclosed by exterior walls and consisting of one or more levels that is suitable for single or multiple functions

Structure: A facility, other than a building or linear structure, which is constructed on or in the land

Linear Structures: A facility whose function requires that it traverse land (such as a road, rail line, pipeline, fence, pavement). Includes distribution systems that provide a common service or commodity to more than one building or structure.

The DM&R information presented relates to all Navy facilities and is not restricted to capitalized assets. The DM&R information excludes assets on Navy installations where a Defense Agency is responsible for maintenance and repair. For these assets, defense agencies are responsible for funding the condition assessment of facilities and reporting a Facility Condition Index (FCI).

M&R Policies
The Navy has migrated and is utilizing the Sustainment Management System (SMS), where applicable, to perform a cyclical assessment of real property facilities and assign an FCI, which considers an asset's key life-cycle attributes such as age and material, as part of a repeatable process that involves field-level condition assessments.

M&R Prioritization
As part of the 'Targeted Facilities Investment Strategy', mission, health and safety considerations are more heavily favored than quality of life, when assigning priority to maintenance needs.

Acceptable Condition Standards
Generally, the Navy considers an asset acceptable when it is in good condition with an assigned FCI of 90% or above.

Capitalization of DM&R
The DM&R information presented relates to all DoD facilities and is not restricted to capitalized assets.

Asset Exclusions
The DM&R information excludes assets on Navy installations where a Defense Agency is responsible for maintenance and repair. For these assets, defense agencies are responsible for funding the condition assessment of facilities and reporting an FCI.

A recruit tosses a heaving line toward the pier inside the USS Marlinspike Seamanship Trainer at Recruit Training Command. (U.S. Navy photo by Seaman Apprentice Mikal Chapman/Released)

EQUIPMENT DEFERRED MAINTENANCE AND REPAIR
For the Fiscal Year Ended September 30, 2020
($ in thousands)

Major Category*	Unaudited 2020		
	FY19 PB-61 Amounts	Adjustments**	FY20 Totals**
1. Aircraft	$ 569,323	$ (242,294)	$ 327,029
2. Electronics and Communications Systems	5,184	(906)	4,278
3. Missiles	26,350	15,947	42,297
4. Ships	525,570	(393,171)	132,399
5. Ordnance Weapons and Munitions	15,811	10,574	26,385
6. All Other Items Not Identified Above	14,321	9,264	23,585
7. Unaudited 2020	—	—	—
Total	**$ 1,156,559**	**$ (600,586)**	**$ 555,973**

Note: *The deferred maintenance amounts reported in the Budget Exhibit Depot Maintenance (PB-61) was used as the basis to identify and report amounts in the Equipment Deferred Maintenance.*
**Amounts include Overseas Contingency Operations (OCO) funding.*
***FY20 values are estimates based on data submitted for BES-21*

Equipment Deferred Maintenance and Repair
DM&R is "maintenance and repairs not performed when they should have been or were scheduled to be; therefore, are put off or delayed for a future period." The information applies to both capitalized equipment, such as ships and aircraft, and non-capitalized equipment, such as ordnance, weapons types, and targets. All items requiring maintenance in FY 2020 are included in the data. The Department of the Navy has not changed prior year policies. Deferred maintenance decreased in FY 2020 primarily due to decreases in aircraft and ship maintenance. This was driven by advanced planning, decreases in unplanned repairs, and decreases in requirements and funding for legacy aircraft.

Aircraft
Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), and component repair. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircraft that have reached their Fixed Induction Date (FID), or unplanned maintenance events (i.e. crash damage). The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance is the difference between validated requirements and funding received.

Airframe rework and maintenance (active and reserve) is performed under the Integrated Maintenance Concept (IMC) program. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but with smaller work packages, thereby reducing out-of-service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity consistent with force levels necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR partners with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

The decrease in aircraft deferred maintenance is primarily due to a decrease in costs associated with unplanned In-Service Repair (ISR) and decreases in requirement/funding for Legacy FA-18 and VH-3D/VH-60N.

Electronics and Communications Systems
The electronics and communications equipment category consist of maintenance performed on a variety of radar, radio, and wire communications equipment. This category refers to deferred systems maintenance for active and reserve Navy assets. In part, the systems include or are associated with the Surveillance Towed-Array Sensor System (SURTASS), P-8 Beartrap, satellite subsystems, the Multi-Band Deployable Antenna, the Multi-Mode Inter/Intra Team Radio, and a variety of radio and radar sets used within the Navy. The total requirement is the planned quantity of systems and their components that require depot level maintenance in a year as determined by program managers and the operating forces. The deferred maintenance is then the difference between the validated requirements and funding received for that fiscal year.

The increase in FY 2020 electronics and communications systems deferred maintenance is due to multiple programs such as Manned Recon, ALQ-99, and Airborne Anti-Submarine Intelligence.

Missiles
Three categories are used to determine missile maintenance: cruise missiles, tactical missiles, and other. Deferred maintenance is defined as the difference between the total weapon maintenance requirement as determined by requirements modeling processes and the weapon maintenance that is funded in accordance with the annual budget controls for the missile maintenance program. The maintenance requirements model projects the quantity of missiles and missile components per weapon system that are required to be maintained or reworked annually.

The increase in FY 2020 missile deferred maintenance is driven by increased maintenance requirements associated with LRASM, SIDEWINDER AIM-9M, SIDEWINDER AIM-9X, and SLAM-ER due to increased flight hours on weapon systems and higher rates of failure.

Ships
Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships' Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot) for active ships. Only depot level maintenance is provided in the calculation of ship deferred maintenance. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints. For U.S. Fleet Forces the FY 2020 decrease in deferred maintenance is due to the cancellation of the USS FORT MCHENRY Designated Ship Repair Availability due to the decision to decommission the ship in FY21 and no deferred maintenance in FY 2020. The reduction in deferred maintenance for U.S. Pacific Fleet was driven by two fewer CNO availabilities, advanced planning, Other Restricted Availability/Technical Availability (ORATA), and continuous maintenance repairs.

Ordnance Weapons and Munitions
Ordnance weapons and munitions are part of a broader category, Other Weapons Systems. This category is comprised of ordnance, end item maintenance for support equipment, camera equipment, landing aids, calibration equipment, air traffic control equipment, target systems, expeditionary airfield equipment, special weapons, target maintenance, and repair of repairable components. Although the various programs vary in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

The FY 2020 increase in ordnance weapons and munitions deferred maintenance is associated with AAE, Bombs, CADS/PADS and GUNS due to increased requirement/funding to increase availability of Condition Code A assets and through-put capacity at prime contractors.

FINANCIAL SECTION US NAVY GENERAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

All Other Items Not Identified Above
This category comprises deferred maintenance for software, arresting gear, lighting and surfacing equipment, and EFTM (external fuel transfer module). The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Increases in FY 2020 are driven by Actual Asset Reports from the fleet and electronic inventory assessment of actual equipment required for Expeditionary Airfield (EAF) Matting, EAF Lighting and EAF Arresting Gear. The increase is also driven by increased training requirement and OPTEMPO utilization for BQM-177, GQM-163A, and Mobile Land Targets in support of the Aerial Targets program.

Sailors wash an MH-60S Sea Hawk helicopter on the flight deck of the Blue Ridge-class command. (U.S. Navy photo by Mass Communication Specialist 1st Class Kyle Steckler/Released)

US NAVY GENERAL FUND
Statement of Disaggregated Budgetary Resources
For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020		
	Research, Development, Test & Evaluation	Procurement	Military Personnel
BUDGETARY RESOURCES:			
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$ 2,872,186	$ 36,964,046	$ 675,421
Appropriations (discretionary and mandatory)	19,753,294	57,209,253	35,584,623
Spending Authority from Offsetting Collections (discretionary and mandatory)	261,969	364,448	459,803
TOTAL BUDGETARY RESOURCES	**$ 22,887,449**	**$ 94,537,747**	**$ 36,719,847**
STATUS OF BUDGETARY RESOURCES:			
New Obligations and Upward Adjustments (total)	$ 20,479,990	$ 72,392,666	$ 36,387,806
Unobligated Balance, End of Year:			
Apportioned, Unexpired Accounts	$ 2,096,222	$ 21,429,395	$ 32,980
Exempt from Apportionment, Unexpired Accounts			
Unapportioned, Unexpired Accounts	—	8,875	—
Unexpired Unobligated Balance, End of Year	2,096,222	21,438,270	32,980
Expired Unobligated Balances, End of Year	311,237	706,811	299,061
Unobligated Balance, End of Year (total)	2,407,459	22,145,081	332,041
TOTAL BUDGETARY RESOURCES	**$ 22,887,449**	**$ 94,537,747**	**$ 36,719,847**
OUTLAYS, NET, and DISBURSEMENTS, NET			
Outlays, Net (total) (discretionary and mandatory)	$ 18,651,600	$ 51,702,744	$ 35,388,945
Distributed Offsetting Receipts	—	—	—
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$ 18,651,600**	**$ 51,702,744**	**$ 35,388,945**

The accompanying notes are an integral part of these statements.

US NAVY GENERAL FUND
Statement of Disaggregated Budgetary Resources
For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020		
	Family Housing & Military Construction	Operations, Readiness & Support	2020 Combined
BUDGETARY RESOURCES:			
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$ 4,358,408	$ 4,547,119	$ 49,417,180
Appropriations (discretionary and mandatory)	6,533,347	59,901,567	178,982,084
Spending Authority from Offset ting Collections (discretionary and mandatory)	358,274	5,923,590	7,368,084
TOTAL BUDGETARY RESOURCES	**$ 11,250,029**	**$ 70,372,276**	**$ 235,767,348**
STATUS OF BUDGETARY RESOURCES:			
New Obligations and Upward Adjustments (total)	$ 5,676,004	$ 67,088,413	$ 202,024,879
Unobligated Balance, End of Year:			
Apportioned, Unexpired Accounts	$ 5,293,957	$ 1,561,788	$ 30,414,342
Exempt from Apportionment, Unexpired Accounts	—	45,166	45,166
Unapportioned, Unexpired Accounts	—	169,248	178,123
Unexpired Unobligated Balance, End of Year	5,293,957	1,776,202	30,637,631
Expired Unobligated Balances, End of Year	280,068	1,507,661	3,104,838
Unobligated Balance, End of Year (total)	5,574,025	3,283,863	33,742,469
TOTAL BUDGETARY RESOURCES	**$ 11,250,029**	**$ 70,372,276**	**$ 235,767,348**
OUTLAYS, NET, and DISBURSEMENTS, NET			
Outlays, Net (total) (discretionary and mandatory)	$ 2,211,766	$ 57,403,389	$ 165,358,444
Distributed Offsetting Receipts	—	(47,561)	(47,561)
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$ 2,211,766**	**$ 57,355,828**	**$ 165,310,883**

The accompanying notes are an integral part of these statements.

THIS PAGE INTENTIONALLY LEFT BLANK

DOD INSPECTOR GENERAL'S TRANSMITTAL LETTER

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

December 15, 2020

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
NAVAL INSPECTOR GENERAL

SUBJECT: Transmittal of the Independent Auditor's Report on the U.S. Navy General Fund Financial Statements and Related Notes for FY 2020 (Project No. D2020- D000FS-0059.000, Report No. DODIG-2021-037)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the U.S. Navy (Navy) General Fund Financial Statements and related notes as of and for the fiscal year ended September 30, 2020. The contract required EY to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the Navy's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency "Financial Audit Manual," June 2018, Updated April 2020. EY's Independent Auditor's Report is attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the Navy General Fund Financial Statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the Navy General Fund's FY 2020 Financial Statements and related notes.

EY's separate report, "Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements Performed in Accordance with Government Auditing Standards," discusses 17 material weaknesses related to the Navy General

Fund's internal controls over financial reporting.* Specifically, EY's report describes the following material weaknesses.

- The Navy did not have adequate documentation of financial reporting policies and procedures including internal controls, did not sufficiently oversee and monitor the financial reporting process and service providers, and did not have internal controls over compliance with accounting standards and regulatory guidance.
- The Navy did not have adequate documentation of Fund Balance With Treasury accounting policies and procedures. Additionally, the Navy did not effectively design or implement internal controls and could not reconcile Fund Balance With Treasury from its general ledger to the U.S. Treasury.
- The Navy did not have adequate accounting policies, procedures, internal controls, and related documentation for property in the custody of contractors. The Navy inappropriately relied on third parties for the accountability and reporting of Trident, Ordnance, and General Equipment – Remainder assets.
- The Navy did not have adequate documentation of accounting policies, procedures, and internal controls for Operating Materials & Supplies – Remainder. Additionally, the Navy was unable to identify a complete population of Operating Materials & Supplies – Remainder assets.
- The Navy did not have adequate documentation of Operating Materials & Supplies – Ordnance accounting policies, procedures, and internal controls. Specifically, the Navy did not sufficiently oversee and monitor ordnance held by the U.S. Army and financial reporting for the ordnance process.
- The Navy did not have adequate accounting policies, procedures, and internal controls to implement accounting standards for Operating Materials & Supplies valuation.
- The Navy did not have adequate accounting policies and procedures, including internal controls or related documentation over utility assets. Specifically, the Navy did not develop or implement a consistent methodology for the accounting of utility assets across the organization.
- The Navy did not have adequate documentation of General Equipment – Remainder accounting policies, procedures, and internal controls. Additionally, the Navy lacked internal controls over physical counts, the implementation of accounting standards, and financial reporting.
- The Navy did not have adequate accounting policies, procedures, and internal controls over Construction in Progress of real property, vessels, and aircraft.

---

* A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the

- The Navy did not have adequate accounting policies, procedures, and internal controls over the environmental and disposal liabilities process to include verifying the completeness and accuracy of data.
- The Navy did not have adequate policies, procedures, and internal controls over the expense and accounts payable processes, including the accounts payable accrual process.
- The Navy did not have adequate documentation of accounting policies, procedures, and internal controls for the reimbursable work order – performer process. Additionally, the Navy lacked adequate controls over financial reporting of revenue transactions.
- The Navy did not have adequate documentation of budget execution policies and procedures and lacked effectively designed internal controls over the budget execution process.
- The Navy did not implement sufficient entity-level control, including documentation of policies and procedures that describe the Navy's environment related to end-to-end business processes, roles, and responsibilities, and the monitoring of service providers, risks, and controls.
- The Navy information systems environment had weaknesses in access controls and segregation of duties, including incomplete and inaccurate user populations, inconsistent user access provisioning and termination processes, and inconsistent periodic review of user access.
- The Navy information systems environment had weaknesses in configuration management, including the logging and monitoring of configuration changes, an incomplete or inaccurate population of system changes, and ineffective segregation of duties within the change management process.
- The Navy information systems environment had weaknesses in its interface processing control (such as a lack of a complete population of interfaces, edit and validation checks, and reconciliations and the inability to determine data transfer completeness, timeliness, and accuracy) that represent significant risk to the Navy's financial information.

EY's additional report, "Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with Government Auditing Standards," discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY's report describes instances in which the Navy's financial management systems did not comply with FFMIA and the Federal Managers' Financial Integrity Act of 1982.

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the Navy's General Fund FY 2020 Financial Statements and related notes.

Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether Navy General Fund's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached December 15, 2020 reports, and the conclusions expressed within the reports.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachments:
As stated

INDEPENDENT AUDITORS' REPORT

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the General Fund of the United States Navy (Navy), which comprise the consolidated Balance Sheet as of September 30, 2020, and the related consolidated Statements of Net Costs, Changes in Net Position, and the combined Statement of Budgetary Resources for the year then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

As described in Note 1, the Navy has not implemented certain accounting standards related to accounting issues for the Department of Defense and the Federal government. The effect on the financial statement amounts involved is not currently determinable by the Navy and could be material.

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Basis for Disclaimer of Opinion

The Navy continues to have unresolved accounting issues and material weaknesses in internal controls that cause the Navy to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on the Navy's financial statements as of and for the year ended September 30, 2020.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that Management's Discussion and Analysis and Required Supplementary Information, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise the Navy's basic financial statements. The Other Information, as listed in the Table of Contents, is presented for the purposes of additional analysis and is not a required part of the financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated December 15, 2020 on our consideration of the Navy's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Navy's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the Navy's internal control over financial reporting and compliance.

Ernst + Young LLP

December 15, 2020

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the General Fund (GF) of the United States Navy (Navy), which comprise the consolidated Balance Sheet as of September 30, 2020, the related consolidated Statements of Net Cost and Changes in Net Position, the combined Statement of Budgetary Resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 15, 2020. Our report disclaims an opinion on such financial statements because the Navy was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered Navy's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Navy's internal control. Accordingly, we do not express an opinion on the effectiveness of Navy's internal control. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to preparing performance information and ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. As described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described below and in Appendix A as items I through XVII to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged

EY
Building a better working world

with governance. We consider the deficiencies described below and in Appendix B as items I and II to be significant deficiencies.

Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the Navy's ability to produce reliable financial statements, accompanying notes, and related disclosures. The Navy's management has not adequately designed financial reporting controls and inappropriately relies on the Navy's financial reporting service provider to execute its responsibilities for the design, performance, and oversight of internal controls over financial reporting. The combination of these deficiencies results in a material weakness. The matters related to Financial Reporting are further described in Appendix A.

II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in the Navy's accounts with the U.S. Treasury. Lack of policies, procedures, internal controls, and supporting documentation prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to FBwT are further described in Appendix A.

III. Government Property in the Custody of Contractors

Government property in the custody of contractors includes government furnished equipment, materials, and contractor acquired property held by contractors on behalf of the Navy. The Navy lacks adequate policies, procedures, controls, and related documentation over the acquisition, disposal, tracking, and inventory processes and places inadequate reliance on third parties over the accountability and reporting of assets. These deficiencies prevent the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to government property in the custody of contractors are further described in Appendix A.

IV. Inventory and Related Property: Operating Materials & Supplies Remainder

Operating Materials & Supplies (OM&S) Remainder (OM&S-R) is a material subset of Inventory and Related Property. It is composed of spare and repair parts not classified as Ordnance, Uninstalled Aircraft Engines (UAE), or Trident Missiles, and consists of assets that are consumed as part of a major end item. Lack of adequate controls over the lifecycle of recording OM&S-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) prevents the Navy from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to OM&S-R are further described in Appendix A.

V. Inventory and Related Property: Operating Materials & Supplies Ordnance

OM&S Ordnance is comprised of ammunition, conventional missiles, torpedoes, component parts for end-items, and equipment for specific uses associated with these items, such as fuel, storage, and transportation. Lack of policies, procedures, internal controls, and supporting documentation, as well as inadequate oversight and monitoring of ordnance held by third parties, prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Ordnance are further described in Appendix A.

VI. Inventory and Related Property: Operating Materials & Supplies Valuation

The Navy's Inventory and Related Property line item consists of OM&S, which the Navy categorizes into the following segments: Ordnance (e.g., ammunition, conventional missiles and torpedoes), Trident missiles (submarine launched nuclear capable ballistic missiles), UAE, and OM&S-R. OM&S consists of tangible personal property to be consumed in normal operations but excludes (a) goods that have been acquired for use in constructing Real Property or in assembling equipment to be used by the entity, (b) stockpile materials, and (c) inventory. Lack of policies, procedures, internal controls, and supporting documentation prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to OM&S valuation are further described in Appendix A.

VII. Property, Plant, and Equipment: Utilities

Property, Plant, and Equipment (PP&E) Utilities consist of overhead and underground distribution networks for electric, water, steam, and sewage; utility plants; and utility assets such as transformers, substations, and switching stations that are made up of multiple components. The Navy has not developed or implemented a consistent methodology for the measurement, composition, and recordation of utility assets across the organization. This prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Utilities are further described in Appendix A.

VIII. Property, Plant, and Equipment: General Equipment Remainder

PP&E General Equipment-Remainder (GE-R) are assets other than vessels, aircraft, and satellites and are primarily composed of equipment used in research, development, and maintenance. The Navy has failed to implement effective policies and procedures over GE-R and lacks controls to adequately record the lifecycle of GE-R (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved Accountable Property System of Record (APSR). This prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to GE-R are further described in Appendix A.

IX. Property, Plant, and Equipment: Construction in Progress

Construction in Progress (CIP) reflects the resources expended to construct PP&E that have not been placed in service as of the end of the fiscal year (FY). The Navy has failed to adequately document policies and procedures over CIP and effectively design key controls to ensure appropriate processing and recording of CIP transactions. This prevents the Navy from substantiating CIP reported balances on the financial statements and notes. The combination of

FINANCIAL SECTION US NAVY GENERAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

these deficiencies results in a material weakness. The matters related to CIP are further described in Appendix A.

X. Environmental and Disposal Liabilities

The Environmental and Disposal Liabilities (EDL) process includes the estimated costs associated with clean-up or disposal of military equipment/programs, base realignment and closure (BRAC), accrued environmental restoration (ERN) and asset closure. The EDL process lacks sufficient and appropriate policies and procedures to identify, detect, and correct inaccurate and incomplete balances in the general ledger, which impact the balances reported on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to EDL are further described in Appendix A.

XI. Expenses and Accounts Payable

Expenses are incurred and recognized when the Navy obtains goods and services from the public or other Federal entities. Accounts Payable (AP) represents the amount owed to third parties by the Navy for goods and services received. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Expenses and AP are further described in Appendix A.

XII. Revenue and Unfilled Customer Orders

Revenue and Unfilled Customer Orders includes amounts earned by the Navy and amounts anticipated to be earned based on existing agreements for services provided. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the Navy from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Revenue and Unfilled Customer Orders are further described in Appendix A.

XIII. Budget Execution and Undelivered Orders

Budget Execution represents the use of appropriated funds from the time the funds are received through the outlay and reporting of those funds. The Navy's Undelivered Orders (UDOs) represents the amount of goods and services ordered which have not been received. Lack of adequate policies, procedures, internal controls and related documentation over the Budget Execution process, including the recognition and reporting of UDOs, prevents the Navy from substantiating reported balances on the Statement of Budgetary Resources and related notes. The combination of these deficiencies results in a material weakness. The matters related to Budget Execution and UDOs are further detailed in Appendix A.

XIV. Entity Level Controls – Oversight and Monitoring

FMFIA requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Navy has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA, leading to inadequate control environment, risk assessment and monitoring

EY Building a better working world

processes. The combination of these deficiencies results in a material weakness. The matters related to Entity Level Controls – Oversight and Monitoring are further described in Appendix A.

XV. Financial Information Systems – Access Controls/Segregation of Duties

Access Controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. We identified access control and Segregation of Duties (SoD) deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Access Controls and SoD and are further described in Appendix A.

XVI. Financial Information Systems – Configuration Management

Configuration Management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematic control changes to that configuration during the system's life cycle. We identified configuration management deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Configuration Management are further described in Appendix A.

XVII. Financial Information Systems – Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. We identified Interface processing deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Interface Processing are further described in Appendix A.

Significant Deficiencies

I. Property Plant & Equipment: Real Property

Real Property includes land, buildings and structures. The Navy has not completely documented policies and procedures over Real Property or fully implemented controls for the processing and recording of Real Property transactions that will enable the Navy to continue to assert to the existence and completeness of its Real Property. These matters result in a significant deficiency. The matters related to Real Property and are further described in Appendix B.

II. Contingent Legal Liabilities

Contingent Legal Liabilities (CLL) represents accrued contingent liabilities pertaining to legal cases where the Office of General Counsel (OGC) or the Office of Judge Advocate General (OJAG) considers an adverse decision probable and the amount of the loss measurable. The CLL process lacks effective controls to ensure the accuracy of the data used to calculate estimates, which impact the reported balances on the financial statements and notes. These matters result in a significant deficiency. The matters related to CLL are further described in Appendix B.

EY Building a better working world

Management's Response to Findings

The Navy's response to the findings identified in our engagement to audit and relevant comments from the Navy's management are provided in their accompanying letter dated December 15, 2020. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

December 15, 2020

Appendix A – Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the Navy's ability to produce reliable financial statements, accompanying notes, and related disclosures. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. According to the Government Accountability Office (GAO) Standards for Internal Control in the Federal Government (commonly referred to as the Green Book) issued under the authority of FMFIA, management is responsible for implementing and evaluating its internal control system, including internal controls to meet reporting objectives related to the preparation of reports for use by the entity, its stakeholders, or other external parties. In addition, according to the GAO Green Book, management may engage third parties to perform certain operational processes for the entity; however, management retains responsibility for monitoring the effectiveness of internal controls over the assigned processes performed by third parties. Despite these requirements, management has not adequately designed financial reporting controls and inappropriately relies on its service provider to execute the Navy's responsibilities for the design, performance, and oversight of internal controls over financial reporting. These control weaknesses, as detailed below, can lead to misstatements on the Navy's financial statements:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the financial reporting process are not accurately or completely documented.
2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.** As noted below, the Navy lacks adequate oversight over financial reporting processes executed across the organization:

   Budget Submitting Offices Financial Reporting Process

   - The Navy does not have adequately documented policies and procedures, including internal controls, to properly reconcile their general ledgers to trial balances (TB) submitted to the Navy's financial reporting service provider, the Defense Finance and Accounting Service (DFAS), including defining the role of Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (FM&C) and the Budget Submitting Offices (BSOs) in that process. In addition, Navy Enterprise Resource Planning (ERP) and Navy Standard Accounting, Budgeting, and Reporting System (NSABRS) do not have system controls in place to prevent Journal Vouchers (JVs) that have not been reviewed and approved from being posted directly into ERP and NSABRS. The Navy does not have appropriate controls to track the JVs recorded each month to ensure they are properly reviewed and monitored or approved by ASN FM&C. This has led to recording JVs that are incomplete, inaccurate, or non-compliant with Treasury Financial Manual (TFM) requirements.

   Office of Financial Management Operations (FMO) Financial Reporting Process

   - ***Financial Reporting Process.*** FMO lacks appropriate oversight and controls related to the JV preparation and review, financial reporting compilation and presentation, and the close process. Currently, the controls in place are not designed effectively, and are missing comprehensive reviews over the financial statements and related disclosures. In addition, the Navy lacks appropriate controls over the preparation and review of recurring and non-recurring JVs, including related reconciliations
   - ***System Conversions.*** FMO lacks adequate oversight and monitoring as well as sufficient policies and procedures over system conversions to ensure timely, accurate and complete financial reporting.
   - ***Navy Standard Accounting, Budgeting, and Reporting System (NSABRS).*** FMO lacks appropriate oversight and controls related to the NSABRS general ledger financial reporting process. Currently, neither the system nor the monitoring controls in place are designed effectively. For example, NSABRS is not sufficiently designed to produce a complete and accurate TB, complete sample document populations, or TFM compliant posting logic. In addition, FMO is not sufficiently or timely reviewing the variances and/or issues noted in monthly reconciliation controls.
3. **Lack of Oversight of Financial Reporting Service Provider.** The Navy lacks appropriate oversight of DFAS related to the execution of financial reporting controls. Specifically, we noted the following control weaknesses:

   Journal Vouchers

   - FMO does not have adequately designed controls over manual and system generated JVs initiated and recorded by DFAS. Specifically, the review process for JVs is not comprehensive and fails to include attributes such as completeness, compliance with the TFM and the review of the support prior to recordation by DFAS.

   Trading Partner Eliminations

   - On behalf of the Navy, DFAS records trading partner eliminations that are not supported by transaction details, and therefore are not compliant with accounting standards. The Navy's unsupported trading partner eliminations impact all of the Navy's Financial Statements. The total amount of trading partner eliminations recorded in the fourth quarter was $33 billion.

   Data Processing

   - Monitoring controls over data processing actions taken by DFAS impacting the financial statements are inadequate. Management relies on DFAS to process financial information through Defense Departmental Reporting System Budgetary (DDRS-B) and Defense Departmental Reporting System Audited Financial Statement (DDRS-AFS), but has not designed sufficient policies and procedures to reconcile its general ledger information against DDRS-B and DDRS-AFS to include verification of the completeness, accuracy, and validity of the trial balances.

   Complementary User Entity Controls

   - Complementary User Entity Controls (CUECs) are controls that users of the service organization (the Navy) should have in place to supplement the service organization's

(DFAS) internal controls. Management has not appropriately designed or implemented CUECs, and therefore, is unable to ensure that controls executed by the service organizations achieve their intended outcome.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.** The Navy lacks adequate financial reporting controls to ensure compliance with applicable accounting standards and regulatory reporting requirements as follows:

Federal Accounting Standards Advisory Board (FASAB) Standards

- As noted on Note 1B, *Basis for Accounting and Presentation*, the Navy is not in compliance with accounting standards established by FASAB. In addition, management lacks policies and procedures over reporting for leases in accordance with accounting standards. Lastly, the Office of the Secretary of Defense (OSD) and Navy have not yet determined a financial reporting policy for Navy's contribution of assets held in the Joint Strike Fighter (JSF) program that meets accounting standards.

Office of Management and Budget (OMB) Circular A-136

- The Agency Financial Report is not in compliance with financial reporting requirements for form and content which includes its financial statements and disclosures as established within OMB Circular A-136, *Financial Reporting Requirements*. For example, activities are not classified appropriately within Note 20 *Reconciliation of Net Cost to Net Outlays,* which reconciles budgetary to proprietary transactions. In addition, Note 20 includes a $3.9 billion budgetary to proprietary difference that was not researched and reconciled in a timely manner.

Treasury United States Standard General Ledger (USSGL)

- The Navy is not in compliance with Treasury's USSGL at the transaction level as required by the Federal Financial Management Improvement Act of 1996. Examples of significant processes that are not recorded in compliance with the USSGL include: Budget Execution, Revenue, Recoveries, and Unfilled Customer Orders.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.**
   - Complete a Process Cycle Memorandum (PCM) that documents the end-to-end process for the entire lifecycle of Financial Reporting, including the initiation, recording, processing and reporting of financial statement data.
   - The PCM should include all key controls, assertions, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all applicable systems and system-generated reports used for the Financial Reporting process.
   - All process owners should review and sign off on the updated PCM to validate that the PCM is complete and accurate.

2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.**

BSOs Financial Reporting Process

- Design and implement policies and procedures governing the assessment and documentation of variances identified during the monthly TB reconciliation process which includes, but is not limited to, whom is responsible for the reconciliations, variance investigation threshold and protocols for timely investigation of variances.
- Design and implement policies and procedures for retention of documentation related to TB reviews and reconciliations.
- Develop a system control to prevent unapproved JVs from being posted.
- Document policies and procedures arising from the development of a new system control, including the monitoring of users with access to oversee the control.
- Perform an analysis over any remaining BSO JVs to identify and correct instances where JVs do not comply with TFM posting logic.
- Design and implement sufficient policies and procedures to ensure any remaining field level JV logs are complete and accurate and reviewed in a timely manner.

FMO Financial Reporting Process

- Develop and implement a methodology that allows for complete and accurate disclosure of financial statement footnotes, including the values presented in the footnotes, relationships between presented accounts, and all variances and reconciling items.
- Design controls that timely reconcile detailed transactions to TBs submitted to DDRS and JVs submitted to Data Collection Module.
- Design sufficient controls to ensure the completeness and accuracy of the data used in TB reconciliations.
- Implement and document controls to verify the completeness and accuracy of reports received from DFAS, prior to using them to perform analysis and as JV support.
- Design policies and procedures which are compliant with required regulations.
- Periodically (at least annually) evaluate and update Standard Operating Procedures to ensure that the procedures described are the procedures performed.
- Implement monitoring controls over DFAS.
- Periodically (quarterly) update Delegations of Authority to reflect personnel changes.

System Conversions

- Continue to design and implement oversight and monitoring controls that address all financial reporting risks throughout the full life cycle of system conversions.
- Ensure that policies and procedures governing all commands' conversions are finalized and approved before conversion procedures begin.

EY Building a better working world

- Develop policies and procedures to minimize i) the duration that a command cannot enter transactions in the target system ("black-out" period) and ii) the duration that a command cannot financially report out of either the legacy or target system ("brown-out" period).
- Establish policies, procedures, and controls to ensure that all accounting functions can be performed and recorded in a timely, complete, and accurate manner during system black-outs and brown-outs.

NSABRS

- Navy should consider whether a system change is required for NSABRS/SABRS to completely and accurately report financial balances.
- Configure the NSABRS GL data to include all key data elements.
- Develop and implement management review controls over posting logic in NSABRS.
- Enhance and implement sufficient management review controls to determine the reasonableness of the explanations provided by DFAS.
- Implement a sufficient management review control to ensure that out of balance conditions identified are researched and resolved in a timely manner for all general ledger system data.
- Evaluate existing policies to ensure that the appropriate procedures are in place to effectively execute a system change without disrupting financial reporting functions.

3. **Lack of Oversight of Financial Reporting Service Provider.**

Journal Vouchers

- Develop policies and procedures for performing a qualitative review and approval of JVs within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and the potential impact on the financial statements.
- Develop more comprehensive policies and procedures for quantitative review and approval requirements within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and potential impact on the financial statements.
- Do not permit DFAS to support JVs with only detail obtained from DDRS-B and DDRS-AFS. Transactional level support should be provided by the Navy.
- Instruct DFAS to only post JVs for which they are able to support by inspecting transaction level detail.
- Record JVs to the appropriate USSGL accounts that are consistent with the business rationale for the transaction.
- Develop and implement control procedures to review DDRS-B system generated JVs at a more precise level of aggregation so that the procedures performed provide comfort over the Navy system generated entries.

EY Building a better working world

Trading Partner Eliminations

- In conjunction with DFAS, coordinate with OSD to address the trading partner eliminations issue at the department level and develop next steps towards remediation, such as updating the Department of Defense (DoD) Financial Management Regulation (FMR).
- Implement document level reconciliations with the Navy's trading partners and develop a process for resolving differences at the document level.

Data Processing

- Document policies and procedures governing the performance, documentation, and assessment of management review controls performed by DFAS on the Navy's behalf.
- Enhance management review and analysis procedures to ensure completeness, validity, and accuracy of the information reported to DFAS and subsequently processed by DFAS through the transaction universe reconciliation.
- Enhance and implement sufficient management review controls to determine the reasonableness of the explanations provided by the system owners.

Complementary User Entity Controls

- Evaluate the current System and Organization Controls (SOC) reports and CUECs to determine if they are appropriate to cover the end-to-end business process.
- Design and implement internal controls that address the CUECs identified in the DFAS SOC 1 reports.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.**
   - Develop and implement policies and procedures that ensure compliance with the applicable accounting authoritative standards.
   - Design and implement policies and procedures to identify, analyze and determine whether leases should be accounted for and reported as capital and operating leases.
   - Develop policies and procedures to review all leasing arrangements and gather the information necessary to support the required disclosure for capital and operating leases in the financial statements, in accordance with OMB A-136.
   - Consider the impact that Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases:* an Amendment of SFFAS 5*, Accounting for Liabilities of the Federal Governmen*t, and SFFAS 6, *Accounting for Property, Plant, and Equipment* will have on these policies when the guidance goes into effect.
   - Work with OSD to finalize an approach for accounting and reporting assets related to the JSF.

II. Fund Balance with Treasury

FBwT represents the aggregate amount of funds in the Navy's accounts with the U.S. Treasury. Reconciliation of agencies' FBwT general ledger accounts to the balances held at Treasury is a key internal control process which ensures the accuracy of the agencies', as well as the government-wide receipt and disbursement data. TFM Chapter 5100, Section 5120 requires agencies to implement effective and efficient reconciliation processes and perform timely reconciliations. Lack of adequate controls over the FBwT process, including reconciliations, can lead to misstatements to the financial statements as well as reports used by management to control the use of its funds. Inadequate procedures, including oversight, over the FBwT process have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of FBwT Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the FBwT process are not accurately or completely documented. This includes roles, responsibilities, processes, and transactions executed at each of its disbursing stations and the process for reconciling to the U.S. Treasury.

2. **Lack of Effectively Designed or Implemented Controls in the FBwT process.** Controls are not designed adequately to ensure deposit-in-transit, suspense, unmatched and interfund transactions are recorded timely and appropriately.

3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.** The Navy's FBwT reconciliation is not adequately designed:

   Unsupported Fund Balance with Treasury Journal Vouchers

   - The reconciliation does not produce a complete population of transactions impacting collections and disbursements. In addition, the Navy does not perform sufficient research and resolution of variances identified during the reconciliation, prior to the recording of JVs to agree the Navy's books to Treasury's reported balance.

   Reconciliation Tool

   - The Navy FBwT Tool (NFT) is designed to identify and reconcile differences between collection and disbursement transaction level data recorded in the general ledger systems, and the net disbursement balances reported to Treasury's Central Accounting Reporting System. However, the NFT is not designed to identify the total unsupported undistributed amount that exists between the Navy and the U.S. Treasury, preventing the reconciliation from being complete. In addition, the tool lacks effective Information Technology (IT) controls over access and change management, which are necessary to provide assurance that the results of the reconciliation are valid.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of FBwT Accounting Policies and Procedures, including Controls.**
   - Finalize a PCM that documents the end-to-end process for the entire lifecycle of FBwT including initiating, recording, processing and reporting of cash transactions, and reconciliations.
   - The PCM should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the FBwT process.
   - Require all process owners to review and sign off on the updated PCM to validate that the PCM is complete and accurate.
2. **Lack of Effectively Designed or Implemented Controls in the FBwT process.**
   - Implement control procedures to require timely research and resolution of variances within 60 business days of transaction date.
   - Implement control procedures to monitor compliance and accountability of those responsible for resolving variances.
3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.**
   - Ensure disbursements and collections are accurately recorded in the general ledger system and financially reported from the general ledger system.
   - Implement a single reconciliation tool that supports the Navy's initiative to utilize Treasury Direct Disbursing from the general ledger systems.
   - Identify the necessary data attributes to identify transactions recorded in suspense specific to the Navy and develop an estimate using relevant, sufficient, and reliable information to record the Navy's suspense account balances on the Navy's financial statements.

III. Government Property in the Custody of Contractors

Government property held in the custody of contractors includes government furnished equipment, materials, and contractor acquired property held by contractors on behalf of the Navy. FMFIA requires federal entities to establish internal controls in accordance with the GAO Green Book. The GAO Green Book states that management may engage third parties to perform certain operational processes for the entity; however, management retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by the third party. Due to lack of adequate policies and procedures, the following control weaknesses exist that can lead to an inability to produce accurate information and data to effectively manage the organization and misstatements on the financial statements.

1. **Lack of or Inadequate Accounting Policies and Procedures, including Controls and Related Documentation.** Policies and procedures do not adequately describe the end-to-end processes to maintain accountability for, or to financially report, property in the custody of contractors. In addition, the Navy does not promptly record dispositions or losses of property in the custody of contractors and its policy fails to address the timely receipt and acceptance of contractor-acquired property.
   - Vendors are not required to perform 100% inventory, or a periodic inventory of components held, and the Navy does not perform comprehensive physical inventories of components held by contractors.

- The Navy does not perform adequate oversight of contractors, including data provided by the contractor that is used to compile the component listing.

2. **Inappropriate Reliance on Third Parties for Tridents.** The Navy relies on contractors for the accountability and reporting of assets. Prime contractors are responsible for the accountability and reporting of the inventory for the Trident Missile program except when the missiles are fully assembled and deployed. Specifically, the Navy lacks oversight to validate the existence, completeness, accuracy, valuation, and related reporting of Trident assets due to the following control weaknesses:
   - The contractor asset listings were not updated appropriately to reflect disposition and consumption of components.
   - Components are not recorded within a government owned system which inhibits the Navy's ability to have real-time information on the status of the components.
3. **Inappropriate Reliance on Third Parties for Ordnance.** The Navy inappropriately relies on contractors for the accountability and reporting of assets. Specifically, the Navy lacks oversight to validate the existence, completeness, accuracy and related reporting of ordnance assets due to the following control weaknesses:
   - In some cases, the Navy relies on contractors who do not have access to government systems to report all changes to the quantity, condition, and physical location of ordnance assets in their custody using a manual process, resulting in inaccurate property records and a lack of current information for management use.
   - Reconciliations are not performed from the quantities noted on hand by contractors to the quantities recorded in the government systems.
   - Contractors for certain missile programs are required by their contract to record the fully-assembled missiles and their component parts in the system at the same time, resulting in double reporting within their accountability records and overstatement of the financial statements.
4. **Inappropriate Reliance on Third Parties for General Equipment – Remainder.** Standard contractual provisions are not utilized to require the reporting of assets acquired by the contractor and owned by the government. As a result, a portion of the Navy assets are not recorded in a government system of record. Additionally, the Navy lacks controls over receipt and acceptance of contractor acquired property, resulting in inaccurate property records and a lack of current information for management use.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Accounting Policies and Procedures, including Controls and Related Documentation.**
   - ASN Research, Development and Acquisition (RDA) should develop and require the use of a standard set of contract clauses that require contractors to validate the completeness and accuracy of lists of the Navy-owned property in the possession of prime and subcontractors at least quarterly.
   - ASN RDA should identify property officers who will be responsible for the Navy property in the custody of contractors.
   - ASN RDA should document policies and procedures for government furnished property and contractor acquired property that include monitoring and oversight over key service providers, including Defense Contract Management Agency (DCMA).
   - ASN RDA should design and implement oversight and review procedures to ensure that DCMA procedures over contractor inventory systems are sufficient to rely upon and to ensure that any instances of non-compliance identified as a result of DCMA reviews are researched and resolved timely.
   - Develop and implement a monitoring control process to verify that contractors perform periodic inventories of assets to the Navy's systems.
2. **Inappropriate Reliance on Third Parties for Tridents.**
   - Develop and require the use of a standard set of contract clauses that require contractors to validate the completeness and accuracy of lists of the Navy-owned property in the possession of prime and subcontractors at least quarterly.
   - Identify property officers who will be responsible for the Navy property in the custody of contractors.
   - Require timely updates to the Navy's property records for all property in the custody of contractors.
   - Complete a risk assessment by contractor and contract type in order to design appropriate oversight functions based on risk.
   - Implement and utilize a government system to track and account for Trident assets.
   - Design and implement standardized processes and procedures to produce an asset listing that reflects on hand inventory.
3. **Inappropriate Reliance on Third Parties for Ordnance.**
   - Develop and implement a process for periodic inventory counts at contractor facilities.
   - Design and implement standard contract clauses for all contracts and service agreements for ordnance held by third parties to include requirements for periodic inventories, causative research when discrepancies are found, and timely updating of the Navy's system.
   - Require and train contractors to timely input all Navy ordnance transactions into the Navy's systems.
   - Design and implement policies, procedures, and internal controls to ensure ordnance transactions are appropriately and timely recorded.

- Provide training to ordnance custodians at contractor facilities to ensure timely and accurate reporting of transactions.

4. **Inappropriate Reliance on Third Parties for GE-R.**
    - Develop and require the use of a standard set of contract clauses that require contractors to provide current and accurate lists of government-owned property in their possession at least quarterly.
    - Identify who will be responsible party for oversight and monitoring of property in the custody of contractors.
    - Require timely updates to property records for all property in the custody of contractors.

IV. Inventory and Related Property: Operating Materials & Supplies Remainder

OM&S-R is a material subset of Inventory and Related Property. It is composed of spare and repair parts not classified as Ordnance, UAE, or Trident Missiles, and consists of assets that are consumed as part of a major end item. In accordance with FMFIA, management is responsible for establishing effective controls to maintain accountability over the assets. There is a lack of adequate controls over the lifecycle of recording OM&S-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) leading to inaccuracies within the Navy's systems and financial statements. Inadequate procedures, including oversight over the OM&S-R process, have led to the following internal control deficiencies:

1. **Lack of, or Inadequate Documentation of, OM&S-R Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for OM&S-R are not accurately or completely documented. The PCM, in its current state, is not a complete representation of key controls, processes, and procedures performed and is inconsistent with how the BSOs initiate, process, record, and report OM&S-R transactions.
2. **Inability to Identify a Complete Population of OM&S-R Assets and Support Related Transactions.** A complete and accurate population cannot be produced for OM&S-R assets and management has failed to provide supporting documentation to substantiate recorded OM&S-R transactions. As noted below, there is a lack of controls to ensure that OM&S-R assets are recorded in an accurate and timely manner in a system of record.

    Incomplete or Duplicate Data

    - The data submitted by BSOs for financial statement compilation is incomplete and inaccurate. For example, asset listings provided by the BSOs have missing values, negative values, and totals that do not agree to financial records. In addition, management cannot distinguish OM&S-R assets versus PP&E or Ordnance. As a result, assets have been duplicated or improperly categorized within populations.

    Variance Resolution

    - Each quarter, material variances are identified between BSOs' property systems and their trial balances. Management is unable to perform causative research in a timely manner to resolve these variances.

    Asset Condition Codes

    - OM&S-R asset condition codes are not standardized or consistently applied across BSOs, leading to inconsistent reporting of the status of assets and preventing management from adequately understanding current asset availability and future asset needs.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of, or Inadequate Documentation of, OM&S-R Accounting Policies and Procedures, including Controls.**
    - Implement policies that require consistent application and compliance with generally accepted accounting principles, Navy, and DoD policies and procedures related to OM&S-R asset management, accounting, and reporting. Include policies over the end-to-end acquisition process such as controlling the buying and receipt of OM&S-R.
    - Develop comprehensive process documentation that describes all key financial control points as they relate to the transaction life cycle of an OM&S-R asset.
2. **Inability to Identify a Complete Population of OM&S-R Assets and Support Related Transactions.**
    - Develop and implement comprehensive policies and procedures to substantiate existence and completeness to include developing a listing of approved systems.
    - Reconcile balances recorded in the financial statements to the balances in underlying asset listings. As part of this process:
        - Perform review and validation of data in underlying asset listings.
        - Perform timely reconciliations and require variances be investigated and resolved. If applicable, adjust the financials because of this research.
    - Design policies and procedures to ensure OM&S-R balances are classified and presented appropriately in the financial statements.
    - Reconcile physical inventory counts to the respective property systems. Document, record, and resolve variances observed in a timely manner to ensure OM&S-R is accurately stated.
    - Develop a uniform use of condition codes and ensure this is consistently utilized across all BSOs.

V. Inventory and Related Property: Operating Materials & Supplies – Ordnance

The Navy's ordnance is comprised of ammunition, conventional missiles, torpedoes, component parts for these end-items and equipment for specific uses associated with these items such as fuel, storage and transportation. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability for all property and other assets for which the agency is responsible. The Navy lacks adequate controls over the recording of ordnance assets leading to inaccuracies in the financial statements. Specifically, inadequate procedures, including oversight, over the ordnance held by others and financial reporting controls for the ordnance process has led to the following internal control deficiencies.

1. **Lack of or Inadequate Documentation of Ordnance Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the ordnance end-to-end controls processes are not accurately or completely documented. For example, specific ordnance processes and procedures for Army-held, contractor-held, and procuring BSOs, Naval Sea Systems Command and Naval Air Systems Command, have not been documented.
2. **Lack of Sufficient Oversight and Monitoring of Ordnance Held by Army.** The Navy cannot identify a complete and accurate population of its ordnance assets held by Army. Specifically, we noted the Navy does not effectively reconcile the amount reported as Army-held ordnance in its system to the on-hand quantities Army is reporting in their system. The reconciliation procedures are not designed to ensure accurate, timely, and consistent execution to accurately report the Navy-owned ordnance held by the Army.
3. **Inadequate or Lack of Controls over Financial Reporting of Ordnance.** The Navy lacks adequate financial reporting controls over ordnance assets. We noted the inputs used to calculate the ordnance gross ending balance are unsupported and cannot be tied back to transactional level detail.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of Ordnance Accounting Policies and Procedures, including Controls.**
   - Update the PCM for the ordnance process to include a complete and accurate end-to-end process for the entire life cycle of ordnance, including the sub-processes for ordnance held by others, specific sub-processes for each BSO, and the related key controls currently in place.
2. **Lack of Sufficient Oversight and Monitoring of Ordnance Held by Army.**
   - Design and appropriately document procedures to ensure the accurate, timely, and consistent execution of the reconciliation of the Army's records to the Navy's records.
3. **Inadequate or Lack of Controls over Financial Reporting of Ordnance.**
   - Update the current policies and procedures for the calculation of the ordnance gross ending balance each quarter. Specifically, the Navy should ensure the inputs to calculate the ordnance ending balance agree to transactional level data.

VI. Inventory and Related Property: Operating Materials & Supplies Valuation

The Navy's Inventory and Related Property line item consists of OM&S, which the Navy categorizes into the following segments: Ordnance (e.g., ammunition, conventional missiles and torpedoes), Trident missiles (submarine launched nuclear capable ballistic missiles), UAE, and OM&S-R assets. The Navy lacks policies and procedures, including internal controls to implement

accounting standards, causing inaccurate presentation of OM&S on the balance sheet and in the related footnote disclosure. Additionally, as noted below, the lack of controls over OM&S prevent full implementation of SFFAS 48 which prevents management from making "an unreserved assertion" that its balances comply with SFFAS 3 prospectively and SFFAS 48 retroactively, including accurately recording OM&S under the consumption method. Specifically, we noted the following:

- The Navy's OM&S has not been revalued using one of the acceptable valuation methodologies set forth by FASAB SFFAS 3 or SFFAS 48.
- Navy management does not have procedures in place to evaluate whether the use of the purchase method of accounting is permitted and appropriate for the BSOs that are continuing to use this method or to periodically reevaluate the appropriateness of its use.
- The Navy does not record an allowance for Held for Repair OM&S assets.
- Navy management is unable to provide adequate support for its current recording of Excess, Obsolete and Unserviceable (EOU) OM&S at a net realizable value (NRV) of zero.
- The annual price update policies and procedures related to OM&S Ordnance, performed by the Naval Supply Systems Command, are not designed to ensure complete, accurate, and consistent application of procedures by the program offices.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Prior to implementing and applying the valuation methodologies set forth by SFFAS 3 and SFFAS 48, the Navy should:
  - Decide what alternate valuation method to use for establishing opening balances. Valuation methodologies used should be based on the best available information to arrive at an alternate value.
  - Outline documentation detailing the implementation plan for SFFAS 48.
  - Establish and implement policies and procedures that comply with SFFAS 3 on a go forward basis.
  - Document the decision process (e.g., policies and procedures) which demonstrates steps taken to validate consistent application of the methodology.
- Evaluate all BSOs utilizing the purchase method of accounting to ensure appropriateness and compliance with Navy policy and procedures.
- Develop policies and procedures to support an allowance methodology for the Held for Repair OM&S and establish that allowance.
- Develop policies, procedures, and a methodology to support the NRV valuation used for EOU OM&S assets.
- Design procedures to ensure the consistent application of the annual price update.

EY Building a better working world

- Design and document key controls around the annual pricing update process to ensure the risks to the Inventory and Related Property line item on the balance sheet are mitigated.

VII. Property Plant & Equipment – Utilities

The Navy's utilities consist of overhead and underground distribution networks for electric, water, steam, and sewage (commonly referred to as linear utility assets), utility plants, and utility assets such as transformers, substations, and switching stations (commonly referred to as parent assets) that are made up of multiple components (commonly referred to as child assets). Commander, Navy Installations Command (CNIC) oversees the Naval Facilities Engineering Systems Command (NAVFAC), which manages and financially reports Real Property assets recorded within the APSR, known as the internet Navy Facilities Asset Data Store (iNFADS). In accordance with FMFIA, management is responsible for establishing and maintaining effective controls to achieve proper accountability for property and other assets for which the agency is responsible.

The Navy does not have adequate policies and procedures, including internal controls, or related documentation over its utility assets which has led to inadequate accounting of these assets. Specifically, management has not developed and implemented a consistent methodology for the measurement, composition and recordation of plant and linear utility assets across the organization. For example, the ownership of utility plant assets is not being consistently accounted for in the iNFADS system. In addition, child asset listings supporting the measurement of parent utility assets are incomplete, inaccurate, and inconsistently documented across installations; this includes the recordation of plant assets in both the child asset listing and as a stand-alone asset.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

- Establish and implement policies and procedures to ensure consistent methodology for the measurement, composition and recordation of utility assets across the organization. For example, ensuring each installation measures assets the same way from standard data sources and determining which plants belong to Navy or are privately owned.
- Establish and implement policies and procedures to determine and appropriately record plant and linear utility asset ownership in iNFADS.
- Establish and implement policies and procedures to enable the Navy to track and accurately maintain records of child utility assets associated to a single parent utility record in iNFADS.
- Establish and implement policies and procedures to ensure the consistent accounting treatment for nonfunctional utility assets.

VIII. Property Plant & Equipment – General Equipment-Remainder

The Navy's PP&E GE-R are assets other than vessels, aircraft, and satellites and are primarily composed of equipment used in research, development, and maintenance. The Navy has not implemented effective policies and procedures over GE-R and lacks controls to record the lifecycle of GE-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved system. Specifically, inadequate procedures, including oversight, over the GE-R process have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of GE-R Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the GE-R process are not accurately or completely documented, including the flow of data through applicable information systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, or the flow of data between stakeholders.
2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.** DoD FMR, Volume 4, Chapter 25, Section 250303, requires independent verification of the accuracy of equipment records through periodic physical counts of general equipment and the counts must also include reconciling the property systems and other systems with the general ledger accounts. Physical count procedures are not designed or operating effectively. Specifically, the Navy has not corrected previously identified conditions such as errors in the asset listing related to inadequate asset location codes and lack of asset disposal recognition. Discrepancies identified during physical counts are not resolved within timelines established in the Navy's policy (30 days) and that policy is not in accordance with DoD instructions for resolution of discrepancies which requires resolution within 7 days. As a result, the capital equipment balance is misstated in the financial statements and notes.
3. **Lack of Policies and Procedures, including Internal Controls to Effectively Implement Accounting Standards.** There is a lack of policies and procedures, including internal controls in place to implement accounting standards, causing inaccurate presentation of GE-R on the balance sheet and in the related footnote disclosure. Specifically, implementation of the provisions of SFFAS 50 to establish opening balances and SFFAS 6 to value assets on a go forward basis have not been completed or fully developed.
4. **Inadequate Controls over Financial Reporting of GE-R.** Controls have not been implemented to report GE-R transactions in a timely manner. A population of GE-R, that reconciles to their financial records, is unavailable and variances are not investigated and resolved prior to preparing the financial statements and notes.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

1. **Lack of or Inadequate Documentation of GE-R Accounting Policies and Procedures, including Controls.**
   - Complete the documentation of the end-to-end process for the entire life cycle of GE-R, including initiating, recording, processing and reporting of GE-R transactions, applicable risks, and key controls that address those risks.
   - Process documentation should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used for the GE-R process.

EY
Building a better working world

2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.**
   - Establish and implement internal controls to ensure location discrepancies are investigated upon discovery and that the location entered in the system is the physical location of the asset, rather than the primary location of the owning activity.
   - Perform timely updates of all required data elements including location, condition and other necessary elements.
   - Implement policies and procedures to record asset transfers, dispositions and losses in a timely manner.
   - Establish policies and procedures and implement an annual physical inventory of assets, to include verification of property existence, data accuracy and completeness, and require updates of specific information about the asset, such as custodian name and physical location.
   - Reconcile the results to the system of record and make all relevant updates following completion of inventory procedures.
   - Complete system adjustments within a timely manner when assets are found or lost between physical inventory periods.
   - Establish and implement internal controls to validate that the complete population of capital GE-R is accurately recorded and presented in the financial statements and to detect any capital GE-R that is not recorded in the financial statements.
3. **Lack of Policies and Procedures, including Internal Controls to Effectively Implement Accounting Standards.**
   - Design policies and procedures to value the Navy's GE-R in accordance with SFFAS 50 and SFFAS 6.
   - Document a detailed implementation plan for SFFAS 50 and SFFAS 6 which includes a detailed description of the process, as well as the proposed application of SFFAS 50 and SFFAS 6.
   - Exercise oversight and perform reviews of valuation calculations for all asset types to ensure accuracy and compliance with federal accounting standards.
4. **Inadequate Controls over Financial Reporting of GE-R.**
   - Establish and implement internal controls to ensure that all reportable GE-R assets are included in the PP&E balance and the related footnote.
   - Consolidate all GE-R into a single Navy system of record for both accountability and financial reporting.
   - Require that each BSO submit accurate and complete asset populations in a timely manner.
   - Implement policies and procedures to require variances identified be investigated and resolved prior to performing financial reporting.

EY
Building a better working world

IX. Property Plant & Equipment Construction in Progress

The Navy's CIP represents the cost of construction work, which is not yet placed in service. In accordance with SFFAS 6, management is responsible for capitalizing the cost of acquiring assets as those costs are incurred and recording them as CIP within the financial statements. Due to inadequate policies and procedures, the Navy has control weaknesses associated with CIP that could lead to misstatements on the financial statements. Additionally, as noted below, the lack of controls over CIP prevent full implementation of SFFAS 50 which prevents management from making "an unreserved assertion" that its balances comply with SFFAS 6 prospectively and SFFAS 50 retroactively, including accurately recording capital improvements:

1. **Lack of Controls Over Real Property CIP.** During the last two quarters of FY20, the Navy designed and began implementation of controls over the recording of Real Property CIP. For projects funded by appropriations other than Military Construction (MILCON), controls are not in place to record CIP assets completely and accurately. For MILCON projects, controls were not in place for an adequate amount of time to ensure that all CIP is properly released when buildings are placed in service and to prevent double counting of CIP with finished assets.
2. **Lack of Controls over General Equipment CIP.** Ineffective controls exist related to CIP for vessels and aircraft. The Navy's method for calculating CIP for major asset classes does not incorporate Research & Development (R&D) costs that should be capitalized, nor does it include overhead costs that are directly related to asset construction. These costs are required to be recorded under SFFAS 6. Navy is unable to provide detailed transactions that reconcile to CIP balances. For Aircraft related CIP, Navy is unable to provide a transaction universe that ties to the Aircraft CIP balance. For Vessels related CIP, Navy is unable to reconcile the CIP summary balance to a transaction universe. Thus, Navy is unable to confirm the completeness and accuracy of CIP balances against the underlying transactions.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Controls Over Real Property CIP**.
   - Revise the existing Real Property procedures to include all life cycle events for Real Property CIP assets to completely and accurately record assets in iNFADS in a timely manner.
   - Complete analysis of the current Real Property CIP projects to validate the accuracy and completeness of the current balance and determine whether an adjustment is necessary to accurately state the CIP balance.
   - Develop and implement policies and procedures to identify and record all CIP for projects above the capitalization threshold.
   - Develop and implement monitoring policies and procedures over the CIP financial compilation process to ensure the reported balance is complete and accurate.

2. **Lack of Controls over General Equipment CIP**.
   - Develop policies and procedures to account for all elements of capitalized cost under SFFAS 6 including R&D and overhead allocations.
   - Develop controls to ensure that quarterly CIP balances reported in the general ledger tie to detailed subledger transactions.

X. Environmental and Disposal Liabilities

EDL includes the estimated costs associated with clean-up or disposal of military equipment including nuclear and conventional vessels, spent nuclear fuel (SNF) and aircraft, BRAC, ERN, and other environmental liabilities (OEL). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that enable the agency to provide reasonable assurance over obligations and costs. During FY20, the Navy has made progress in updating process documentation and implementing new controls. However, the Navy lacks effective controls over their end-to-end EDL processes which could lead to misstatements in amounts reported within the financial statements and contributed to the following weaknesses in internal controls:

1. **Inadequate Policies, Procedures and Related Controls over EDL.** Policies and procedures are not sufficient to ensure proper documentation, including key assumptions or judgments made, is created and maintained to support cost estimates. The methodology for allocating program costs across multiple programs is not appropriately documented in the ERN process. Lastly, the ERN process lacks consistent procedures for escalating cost estimates established in prior years.
2. **Lack of Effectively Designed or Implemented Controls in the EDL Process.** Controls are not designed adequately to verify the completeness and accuracy of data used in spreadsheets and other internally generated reports. This data includes inputs and key assumptions used in calculating the EDL estimate for aircraft and ERN. No controls exist to ensure OEL estimates over five years are updated in accordance with Navy policy. In addition, controls are not designed effectively over the use of ERN estimation modeling tools.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Inadequate Policies, Procedures, and Related Controls over EDL**.
   - Establish and implement internal controls designed to ensure that each cost estimate in the population has sufficient and appropriate support for cost inputs and documentation of estimate assumptions.
   - Establish and implement review procedures to ensure compliance with internal policy updates.
2. **Lack of Effectively Designed or Implemented Controls in the EDL Process**.
   - Develop and implement internal control testing procedures, to monitor effectiveness of the control environment, for each category of EDL estimate.

XI. Expenses and Accounts Payable

AP represents the amount owed to third parties by the Navy for goods and services received. Expenses includes all costs that are incurred but not capitalized on the balance sheet. Expenses and AP include key subprocesses from the procure to pay (P2P) business processes, including Contract Vendor Pay (CVP), Military Standard Requisitioning and Issue Procedures (MILSTRIP), Transportation of People (TOP), Transportation of Things (TOT), and Reimbursable Work Order – Grantor (RWO-G). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenses applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The Navy's current policies, procedures, and key controls over its end-to-end expense and AP processes do not address financial reporting risks, leading to misstatements in amounts reported within the financial statements. Specifically, we noted the following issues during our testing:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.** Controls over the expenses and AP process are not properly designed as detailed below:

   Posting of Expenses and AP

   There is a lack of controls to ensure that expenses and AP are posted timely or at the appropriate amount, or to ensure that they are adjusted upward or downward when needed, in both Navy ERP and legacy systems. Specifically, expenses and AP were not posted in a timely manner for the CVP, MILSTRIP, TOP, TOT, and RWO-G processes.

   Receipt and Acceptance

   There is a lack of sufficient controls to ensure that goods and services are reviewed, received and accepted prior to payment in both Navy ERP and legacy systems. Specifically, the Navy was unable to provide receipt and acceptance support for CVP, RWO-G, and TOT transactions.
2. **Lack of Sufficient AP Control Environment.** There is a lack of sufficient controls surrounding the AP accrual process. In addition, there is a lack of support surrounding the transaction scoping and appropriation allocation utilized in the current cash regression AP estimation. Further, the AP accrual materiality thresholds and underlying data outlined in the accrual methodology are insufficient and lack precision.
3. **Lack of Effectively Designed System Migration Process.** There is a lack of sufficient and/or consistent training for key financial personnel across migrating commands leading to misstatements in amounts reported in the general ledger system. Specifically, commands recently migrated to NSABRS have expense and AP balances that are invalid and/or abnormal.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.**

EY
Building a better working world

- Assess the system interfaces to determine whether expenses and payables are able to post automatically and develop or fix those interfaces as appropriate.
- Manually post payables which cannot be posted via interface timely.
- Identify the unsupported transactions and determine whether an adjustment is necessary to accurately state the AP and budgetary balances in accordance with the timeline provided by the PCM:
  - Develop and implement procedures to ensure transactions are posted accurately and timely.
  - Develop and implement document retention policies for receipt and acceptance procedures.
- Implement additional monitoring of when the receipt of an order is received to when the receipt is uploaded into the general ledger system to ensure timely recording of the expense and payable:
  - Enhance review over three-way match controls.
- Increase leadership communication across commands to ensure that controls are executed consistently.

2. **Lack of Sufficient AP Accrual Process.**
   - Design and implement additional policies, procedures and controls around the AP accrual process:
     - Design a lower targeted materiality threshold as the AP accrual model matures to obtain increased precision.
   - Document the basis of the allocation methodologies across general ledger accounts affecting CIP, OM&S, Operating Expense, or any other accounts for the AP accrual, as appropriate.
3. **Lack of Effectively Designed System Migration Process.**
   - During monthly monitoring, Navy and DFAS should research the cause of abnormal documents and document that research and the resolution of abnormal conditions.
   - Implement necessary system controls to prevent processing errors in the NSABRS system

XII. Revenue and Unfilled Customer Orders

Revenue and Unfilled Customer Orders includes amounts earned by the Navy and amounts anticipated to be earned based on existing agreements for services provided. The Navy's Revenue and Unfilled Customer Orders falls within the scope of the RWO – Performer (RWO-P) process. This includes all processes involved in recognizing revenue and recording the related budgetary entries including Unfilled Customer Orders. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that revenues applicable to the agency operations are properly recorded and accounted for to permit

EY
Building a better working world

the preparation of reliable financial reports and maintain accountability of assets. Inadequate procedures over the RWO-P process has led to the following control weaknesses:

1. **Lack of or Inadequate Documentation of RWO-P Process Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, general ledger accounting systems, and related control activities over the RWO-P process are not adequately or completely documented. As a result, the RWO-P process is executed inconsistently across the organization.
2. **Ineffective or Inadequate RWO-P Procedures.** Procedures do not exist outlining the appropriate use of reimbursable agreements, identification and elimination of intra-Treasury Account Fund Symbol transactions and recording and monitoring (including segregation of duties) of reimbursements the Navy receives from the DoD Foreign Military Sales (FMS) program. The lack of adequate procedures has resulted in misstatements on the financial statements.
3. **Lack of Effectively Designed Controls in the RWO-P Process.** Controls over the RWO-P process are not effectively designed. Specifically, the Navy has not:
   - Implemented a comprehensive review over incoming sales order funding documents recorded in the general ledger to determine validity and accuracy prior to acceptance.
   - Designed sufficient review controls to review billing files and correct variances prior to certification by DFAS.
   - Designed adequate procedures around RWO-P close-out. Specifically, controls for Unfilled Customer Orders are not designed to ensure that all terms and requirements have been met prior to close out and are not closed-out in a timely manner after the work is completed.
   - Designed controls around funds collected to validate collections reconcile back to the performance of work, provision of goods, or are recorded in the period in which the services or goods were provided.
   - Designed controls to ensure appropriate reimbursement has been collected when costs are incurred in the performance of services or when goods are provided.
   - Designed monitoring and oversight controls for the RWO-P process, increasing the risk that reimbursable agreements are invalid and recorded incorrectly in the general ledger.
4. **Inadequate Controls over Financial Reporting of Revenue.** Navy lacks policies, procedures, and related controls to ensure revenue transactions are in compliance with accounting standards. Specifically, revenue is not recorded when services or goods are provided, but instead, recorded when bills are issued in the general ledger. In addition, advance payments are incorrectly recorded due to posting logic issues and documentation to support recorded transactions was not available.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of RWO-P Process Accounting Policies and Procedures, including Controls.**
   - Perform an assessment of the RWO-P end-to-end process to ensure all distinct systems, processes, procedures, and key controls are documented in the PCM. In addition:
     - The PCM should include all financial statement assertions, key control process owners, key supporting documentation, and applicable GL systems and data interfaces in the RWO-P process.
   - Develop and implement policies and procedures to validate that the RWO-P process is uniformly and consistently executed.
2. **Ineffective or Inadequate RWO-P Procedures.**
   - Design policies to ensure the appropriate use of reimbursable agreements, including the evaluation of whether there is a more appropriate method for distributing funds within BSOs, such as reprogramming or transferring.
   - Design, document, and implement control procedures to ensure that key aspects of an event are properly segregated amongst personnel when processing an internal FMS RWO. In addition:
     - Implement non-automated review procedures to ensure the validity of FMS RWO documents and procedures to monitor funding within the budget of each command.
   - Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.
3. **Lack of Effectively Designed Controls in the RWO-P Process.**
   - Design, document and implement detailed control procedures in the RWO-P process to require all relevant data elements are included on the reimbursable documentation and entered into the general ledger systems. Additionally, implement appropriate monitoring over the execution of the agreements including the billing, collection and closeout cycles.
   - Develop and implement sufficient review procedures to ensure key controls within the PCM are effectively communicated and consistently adhered to by the BSOs and by the Navy's service providers.
   - Develop automated controls and appropriate system interfaces as a part of the implementation of a system solution for intragovernmental transactions such as Government-Invoicing.
   - Implement comprehensive review controls to validate that policies and procedures regarding the RWO-P closeout process are being consistently applied across BSOs.

FINANCIAL SECTION US NAVY GENERAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

4. **Inadequate Controls over Financial Reporting of Revenue.**
   - Develop and implement policies and procedures to require revenue be recognized timely and in the appropriate period as well as recorded accurately including procedures for revenue accruals and management review controls.
   - Perform a detailed review of RWO-P business processes, including advances from others, and respective posting logic to identify and address all non-compliant processes and posting. In addition:
     - Update system posting logic to comply with appropriate accounting guidance for non-compliant processes.
     - Update policies and procedures to outline the appropriate use of RWO-P transactions as well as how to appropriately account for other types of cash receipts that are not RWO-P.

XIII. Budget Execution and Undelivered Orders

Budget execution represents the use of appropriated funds, authorized by Congress and apportioned by OMB, from the time the funds are received through the outlay and reporting of those funds. UDOs represent the amount of goods or services ordered which have not been received. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenditures applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The current procedures over the end-to-end budget execution process, including the recognition and reporting of UDOs and the related execution of funding as performed by the Navy Office of Financial Management and Budget, do not address financial reporting and budget management risks and could lead to misstatements in amounts reported within the financial statements as detailed below:

1. **Lack of or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the budget execution process are not accurately or completely documented. In addition, there is no enterprise wide policy and related procedures for recording bulk obligation estimates. Estimates are not reviewed and adjusted as execution data becomes available, leading to the potential loss of resources as unneeded funding cannot be reprogrammed timely. Additionally, the estimates do not have adequate analysis to support their recording.
2. **Lack of or Inadequate Budget Execution Procedures.** The Navy does not have effective policies and procedures in place to ensure that all stakeholders prepare and retain consistent and sufficient supporting documentation to support budget execution transactions. Specifically, the Navy was unable to provide sufficient supporting documentation to justify transactions posted and the associated UDO balances. Additionally, procedures outlining the appropriate use of reimbursable agreements and the identification and elimination of intra-appropriation transactions have not been established. In some cases, the lack of procedures has resulted in misstatements on the financial statements.

Building a better working world

3. **Lack of Effectively Designed Controls in the Budget Execution Process.** Controls over the budget execution process are not properly designed as detailed below:

Posting of Obligations

- There is a lack of controls to ensure that obligations are posted timely or at the appropriate amount, or to ensure that they adjusted upward or downward when needed, in both Navy ERP and legacy systems.

Monitoring of Obligations

- There is a lack of controls to ensure obligations are monitored appropriately throughout their period of availability, including the execution of funding against obligations.
- The Navy lacks appropriate review of dormant obligations and does not timely de-obligate when execution against an agreement ends. Specifically, for agreements that have had no execution against them for over 90 days, the Navy was unable to provide sufficient evidence that a review occurred to confirm the validity of the obligation. Lack of timely de-obligation of agreements overstates the obligated balance and understates available funds that can be used by Navy for mission critical expenditures.

Funds Control

- The Navy lacks proper controls over budget authority. The Navy does not effectively record budget authority within the general ledger nor reconcile budget authority reflected within its general ledger systems, including legacy systems, against the Program Budget Information System (PBIS). PBIS reflects budget authority granted to the Navy by Congress. The Navy does not make corrections based on the identified variances and cannot support many of the variances, leading to inaccuracies in its general ledger. This increases the risk of non-compliance with the Anti-deficiency Act.

Recommendations

Consider the following corrective actions related to the deficiencies identified:

1. **Lack of, or Inadequate Documentation Budget Execution Policies and Procedures, including Controls.**
   - Complete the PCM for the budget execution process to document a complete and accurate end-to-end process for the entirety of the lifecycle, including the initiation, recording, processing, and reporting of transactions.
     - The PCM should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used.
   - Implement a Navy-wide policy requiring obligation estimates be recorded and documented.

Building a better working world

2. **Lack of, or Inadequate Budget Execution Procedures.**
   - Increase communication amongst various P2P stakeholders to ensure sufficient and complete documentation is readily available and consistently provided as part of all documentation requests for the budget execution process.
     - Evaluate, identify, and mitigate key gaps and inconsistencies in current document retention policies and procedures.
   - Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.
3. **Lack of Effectively Designed Controls in the Budget Execution Process.**
   - Evaluate existing controls to ensure that the appropriate monitoring procedures are in place, including record retention policies.
   - Evaluate existing policies and procedures over the UDO process to ensure that the appropriate procedures are in place to ensure timely de-obligation of funds.
   - Focus efforts on monitoring active obligations before they become dormant including the related expenditures. This will increase visibility into funds actually needed for valid business purposes versus funds that can be de-obligated and used for other mission critical needs.
   - Eliminate the PBIS overlay by accurately recording and managing budget authority directly in the general ledger system.
   - Implement monitoring controls over the authority recorded and distributed in the general ledger system.

XIV. Entity Level Controls – Oversight and Monitoring

DoD Instruction 5010.40 requires DoD entities to comply with the requirements of the FMFIA and OMB Circular A-123 *Management's Responsibility for Enterprise Risk Management and Internal Control*. FMFIA requires federal entities to establish internal controls in accordance with the GAO Green Book. The GAO Green Book defines entity level controls as controls that have a pervasive effect on an entity's internal control. It establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. In accordance with the GAO Green Book, management must effectively design, implement, and operate each of the components of internal control for the components to be effective. The Navy has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book and OMB Circular A-123 requirements as described below:

1. **Inadequate Control Environment.** An entity's control environment provides the discipline and structure to help the entity achieve its objectives. According to the GAO Green Book, a key principle in establishing an adequate control environment is the appropriate documentation of the internal control system including the five components of internal controls. The GAO Green Book further states that this type of documentation provides a means to retain organizational knowledge and mitigate the risk of having that knowledge

limited to a few personnel. The documentation also provides a means to communicate, as needed, that knowledge to third parties, such as external auditors. A lack of documentation identifying process controls can lead to inadequate communication to those responsible for control performance, as well as inappropriate execution and monitoring of controls. We noted the following deficiencies in the Navy's control environment:

Entity Level Controls and Documentation

- The current control environment is ineffective due to inadequate design of entity level controls and lack of proper end-to-end documentation of key business processes including internal controls.

System Consolidation and Data Migration

- According to the GAO Green Book, management should document internal controls to meet operational needs. Documentation of controls, including changes to controls, is evidence that controls are identified, documented, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity. The Navy does not have adequate documentation over the internal controls supporting system consolidations and data migration activities occurring on Navy systems. Due to the lack of adequate documentation and governance, there is a lack of communication to the responsible BSO and financial organizations overseeing system consolidation and data migration efforts, as well as inadequate monitoring of the activities performed. Specifically, the identified system consolidation and data migration weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:
  - Overarching system consolidations governance (e.g., policies, procedures, and minimum activities), to include monitoring does not exist.
  - Overarching legacy system decommissioning procedures and/or guidance across all Navy functional areas have not been developed to manage and verify the appropriate shutdown and decommissioning of legacy systems no longer in use by Navy organizations, Commands, and/or BSOs.
  - Requirements and/or evidence to demonstrate accounting functions are no longer being performed for migrated BSOs when the legacy system remains in use by other organizations/BSOs.
  - Migration specific project plans governing the migration activities for system consolidation efforts, to include but not limited to, the impacted legacy system, future state system, and BSOs do not exist.
  - Pre-migration conversion testing to demonstrate data designated to be migrated converted successfully and without error, or that any errors identified are resolved and retested, or analyzed, and determined to not pose a risk to the completeness and accuracy of the migration results are inadequate.

2. **Lack of Risk Assessments.** According to the GAO Green Book, management should assess the risks facing the entity as it seeks to achieve its objectives by identifying, analyzing, and responding to risks related to achieving the defined objectives. A comprehensive entity level risk assessment does not exist, nor has the Navy fully identified financial reporting risks for the majority of its key business processes.

3. **Inadequate Monitoring Controls.** According to the GAO Green Book, management should establish and operate activities to monitor the internal control system, evaluate results, and remediate identified internal control deficiencies on a timely basis. In addition, it states that management may engage third parties, such as service organizations, to perform certain operational processes for the entity; however, it retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by service organizations. OMB Circular A-123 requires that management evaluate the effectiveness of internal controls annually using the GAO Green Book. The current control environment lacks adequate monitoring controls to evaluate the effectiveness of the internal controls for the majority of its key business processes. In addition, as noted below, the Navy does not have proper oversight of service organizations and other third parties:

DFAS

- DFAS performs key financial reporting controls on management's behalf; however, DFAS procedures are not designed to verify the completeness and accuracy of the data within the reports utilized. Additionally, compensating controls do not exist to mitigate the risks posed by DFAS's control weaknesses.

DCMA

- DCMA validates existence and completeness of government owned property; however, DCMA's procedures are not sufficiently designed for that purpose. Additionally, compensating controls do not exist to mitigate the risks posed by DCMA's control weaknesses.

Contractors

- The Navy does not have adequate oversight of contractors that hold property on its behalf. In addition, there is inconsistent reporting by contractors regarding the property that they hold, leading to unreliable asset reporting, which can have an impact on the Navy's operations.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Inadequate Control Environment.**

Entity Level Controls and Documentation

- Complete the design and emphasize the importance of the A-123 program at all levels of the organization from Navy leadership. This is necessary to bring visibility, education and support to the program from across the organization and at the highest levels of leadership.
- Identify, document and communicate roles and responsibilities throughout the Navy as they relate to the implementation of an A-123 program. Ensure the proper groups and personnel that are involved are trained at the appropriate levels to produce the most

EY
Building a better working world

effective results. Integrate financial management (FM) and IT remediation efforts to achieve a more efficient and effective program.

- Develop, document and maintain supporting documentation as a part of the A-123 program and for the Enterprise Risk Management to evidence the development of management control plans, performance of risk assessments, ongoing monitoring, development of corrective action plans and tracking of progress towards remediation.

System Consolidation and Data Migration

- Develop, document, and implement policy and procedures that define governance structures, minimum activities, and include an enterprise-wide monitoring program for all system consolidations and data migrations efforts.
- Strengthen the integration and collaboration between IT and FM organizations throughout the system consolidation lifecycle to promote a holistic, continuous evaluation, and understanding of risk as part of the development and implementation of the Department-level governance and system consolidation enterprise-wide monitoring program.
- Develop, document, and implement system decommissioning procedures and requirements that effectively manage, control, and verify the appropriate shut-down and decommissioning of legacy systems no longer in use.
- Develop and implement procedures that effectively verify all financial activities and transactions are no longer being performed or recorded in a legacy system and develop a checklist that can be used to validate that the procedures established have been appropriately executed, effectively demonstrate that the legacy system is no longer performing accounting functionality, and serve as evidence for investigative purposes.
- Include requirements that migration-specific project plans (specific to each migrating/impacted BSO, legacy system, and future state system) are developed, implemented, and adhered to.
- Develop and document procedures for conducting the system consolidation conversion documentation tracker process that includes clearly documenting results of all iterations of all pre-migration conversion testing, analysis performed by appropriate stakeholders in situations where errors are identified, and evidence demonstrating that significant errors identified are resolved and re-tested as needed prior to migration.

2. **Lack of Risk Assessments.**
   - Policy needs to include proper detail and guidance for conducting the risk assessment process, including:
     - A process to review all aspects of the risk management processes at least once a year.
     - Review of the previous risks identified with appropriate frequency.
     - Provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed.

EY
Building a better working world

3. **Inadequate Monitoring Controls.**

   DFAS/DCMA
   - Assess policies and procedures governing oversight of third-party service providers and identify the appropriate level of oversight and monitoring required to ensure accurate and complete reporting.
   - Design management review controls related to actions performed by DFAS and DCMA that are appropriate and/or develop procedures to mitigate the risks identified. Retention of adequate documentation evidencing the procedures performed during their review should include, but is not limited to:
     - Procedures performed/reperformed.
     - Verification that the data transferred from a system of record to an End User Computing tool, such as Excel, is not lost, added, or changed.

   Contractors
   - Identify the level of oversight required of contractors that have government property in their custody and develop the appropriate policies and procedures to implement the actions necessary for consistent and effective oversight and periodic monitoring.
   - Implement changes to contracts to allow for contractors with property in their custody to accurately report the property in accordance with federal accounting standards. Include in the contracts the actions necessary for government personnel to monitor the reports and data presented for accuracy.

Financial Information Systems

The Navy needs to continue to focus on implementing a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Consequently, a prioritized, risk-driven effort, is still necessary to remediate deficiencies in the areas of Access Controls, SoD, Configuration Management, and Interface Processing. Our assessment of the IT controls and the computing environment focused on a subset of financially significant applications that included general ledger systems, feeder systems and operational systems. The following table outlines the number of deficiencies identified across the 30 systems in scope for the GF.

	FY20 Navy Financially Significant Systems – IT Internal Controls Deficiencies				
System Type	Security Management	Access Controls/ SoD	Configuration Management	Interface Processing	Totals
General Ledger Systems	15	52	20	32	119
Feeder and Operational Systems	32	250	144	100	526
Totals	**47**	**302**	**164**	**132**	**645**

Based on the results outlined above, we noted the following:

- 92% of all control deficiencies identified across all system types map to high-risk control domains (i.e., access controls, segregation of duties, configuration management and interface processing)
- 47% of control deficiencies are a result of Access Control/SoD deficiencies
- 25% of control deficiencies are a result of Configuration Management deficiencies
- 20% of control deficiencies are a result of Interface Processing deficiencies

A subset of the deficiencies identified were high-risk, which collectively constitute a material weakness in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate. Based on our review and analysis of the findings in aggregate, we have identified three distinct material weaknesses related to information system controls.

We have outlined the three IT material weaknesses below:

- Access Controls/SoD
- Configuration Management
- Interface processing

Each of the IT material weaknesses are discussed further below.

XV. Access Controls/Segregation of Duties

Access controls include those related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. When properly implemented, access controls can help ensure that critical systems assets are safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- Complete and accurate, system generated, populations of users were not consistently available, or evidence to support this was not provided, to include source and level of access granted.
- Definition of financially significant transactions and resources has not been performed and/or lacks financial oversight.
- User access provisioning to include initial access provisioning, modification, and removal were not performed in accordance with defined requirements, timelines, and with sufficient detail to confirm access currently granted in the system was commensurate with access approved and required for the users' business function.

- User access recertification/periodic user access reviews were not performed to consistently evaluate both the need for access and the level of access provisioned.
- Monitoring of sensitive user activities, including activities of privileged users, was not documented, not being performed, or not configured appropriately within systems.
- Audit logging information was not protected against unauthorized access and modification, as well as not being retained for the audit period.
- Definition and control of security violations and monitoring, to include required follow on actions and removal of access, was inconsistent.

An effective control environment guards against a particular user having incompatible functions within a system. SoD controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

The identified SoD weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- Cross-application SoD analysis has not been performed across key financial systems to determine the significance and pervasiveness of these types of SoD conflicts. Additionally, cross application SoD are not considered when provisioning user access.
- SoD matrices or equivalents were not consistently documented, inclusive of all functional roles, and/or not mapped effectively to the system access associated with the functional roles.
- Assigning of conflicting roles during the access provisioning process could not be prevented, and for known conflicts where SoD concerns were identified, there was a lack of documentation for business rationale and subsequent monitoring of a user's activity.
- Multiple systems had a significant number of administrator users (i.e., database administrators, developers) able to complete an entire functional process by inputting, processing, and approving transactions.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Systematically generate population of users and incorporate completeness and accuracy procedures into review controls to confirm a holistic evaluation of the user base. Implement monitoring and review controls for users with elevated access privileges.
- Define financially significant transactions and resources and obtain approval from the appropriate level of IT and financial oversight.
- Establish and consistently follow processes and controls related to user account management and SoD, including the entire life cycle from access provisioning to recertification, modification of access, inactivity restrictions, and termination procedures.

- Segregate roles, and where conflicting roles are required or unavoidable, document business rationale and monitor activities of users.
- Evaluate cross-application SoD to identify potential conflicts for users accessing multiple systems.
- Conduct appropriate analysis to confirm functional user access is tied to the appropriate logical permissions within the systems and confirm SoD is enforced.
- Re-enforce/disseminate guidance as it relates to defining required security violation monitoring procedures, and establish governance around the frequency for which security violations should be escalated, to whom, and management's required actions.

XVI. Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system's life cycle. By implementing configuration management controls, the Navy can ensure that only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

The identified configuration management weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- Complete and accurate, system generated, populations of changes made to the production environments are not captured nor available to support internal controls and monitoring. This includes code changes, direct data changes, configurable settings within the application, and changes to interfaces.
- Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application, database, interfaces, and data.
- Environment is not segregated; developers have access to the production environment. Additionally, access to source code is not properly controlled.
- Configuration changes are not properly reviewed, approved, and documented.
- There is no management review or monitoring of third-party providers, who perform many aspects of the configuration management functions for the relevant applications, to ensure compliance with the currently approved configuration management process.
- Inadequate governance and requirements during system conversion/consolidation activities resulted in critical financial reporting discrepancies and risks to the financial statement.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Identify complete and accurate populations of configuration changes in order to monitor changes and determine only authorized and approved changes are being applied to production.
- Segregate access between development and production environments.
- Restrict access to source code and document authorization and business need for those that require this access to perform their job roles and responsibilities.
- Establish controls to monitor third party support organizations associated with the configuration management of the Navy's applications.
- Establish audit logging capabilities in order to monitor changes made to the application, database, interface and data to ensure they are authorized.
- Implement governance as it relates to system conversions, such that adequate testing and remediation of known errors is performed by both IT and Financial stakeholders prior to the conversion/go-live.

XVII. Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the Navy financial management information systems environment include the following:

- A complete population of interfaces, systematically generated or systematically validated, could not be provided to support the complete and accurate processing of the Navy's transactions.
- Edit and validation checks are not consistently implemented across financially significant interfaces to prevent the processing of duplicate or inaccurate data.
- File-level reconciliations are not being performed between source and target systems to ensure completeness and accuracy of processing.
- Logs of interface processing activities are not retained to support subsequent auditing and monitoring; error reporting for failed interface processing activities has not been implemented in some systems.
- Interface files are not protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.
- Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.

Recommendations

Consider the following corrective actions related to the conditions described above:

EY Building a better working world

- Conduct an appropriate analysis and implement procedures to confirm that the population of interfaces is complete and accurate.
- Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access. Conduct an appropriate analysis of a complete and accurate population of edit checks and validations to then determine which are financially significant within the interface process. After this analysis, determine if the interface files are being subject to appropriate validation and edit checks and that they are operating as designed.
- Implement controls to confirm that the information received or sent from a target to source application is complete, accurate and consistently received.
- Test system interfaces in an end-to-end manner for the Navy to gain reasonable assurance that system consolidation efforts will retain desired/intended functionality.
- Implement consistent controls to log interface activity and monitor these logs to allow for timely remediation of errors associated with the transmission of data used in financial reporting.
- Management should protect data files transmitted via interfaces from inadvertent or intentional access or modification prior to data processing.

EY Building a better working world

Appendix B – Significant Deficiencies

I. Property Plant & Equipment – Real Property

The Navy's Real Property consists of land, buildings, and structures, the latter of which is segmented into linear and non-linear structures and utilities. Commander, Navy Installations Command oversees the Naval Facilities Engineering Systems Command, which manages and financially reports real property assets recorded within the Accountable Property System of Record, internet Navy Facilities Asset Data Store (iNFADS). In accordance with the Federal Managers Financial Integrity Act of 1982, management is responsible for establishing and maintaining effective controls to achieve proper accountability for all funds, property and other assets for which the agency is responsible. Due to the significance of Real Property, a robust control environment is essential.

The Navy has designed and is currently implementing controls over the lifecycle of recording Real Property (i.e., receipt, acceptance, maintenance, issuance, and disposal) and related documentation, which are critical to maintaining the outcomes of that effort in the next fiscal year:

1. **Lack of, or Inadequate Documentation of Real Property Accounting Policies and Procedures, including Ineffectively Designed Controls.** The Navy's Real Property Process Cycle Memorandum (PCM) failed to adequately document the end-to-end processes, procedures, and key control points for significant areas such as acquisitions and disposals of Real Property and inventory procedures such as asset evaluation and virtual inventory reconciliations. The lack of adequate documentation has led to inconsistencies in the execution of Real Property procedures across the organization.
2. **Inadequate Financial Reporting Controls Over Real Property.** The Navy failed to design or implement effective controls over the Real Property process. Specifically, the Navy has not adequately designed internal controls to ensure Real Property data is accurately and timely recorded in iNFADS.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

1. **Lack of, or Inadequate Documentation of Real Property Accounting Policies and Procedures, including Ineffectively Designed Controls.**
   - Revise the end-to-end process documentation to ensure that it is comprehensive, complete, and speaks to all key financial control points in the various stages of the transaction life cycle of a Real Property asset, as well as but not limited to: inventory procedures, additions and disposals of Real Property, valuation, impairment, deferred maintenance, calculation of accumulated depreciation and depreciation expense, and financial reporting controls.
2. **Inadequate Financial Reporting Controls Over Real Property.**
   - Implement policies and procedures to ensure the revised process is consistent with field level operations.

Building a better working world

II. Contingent Legal Liabilities

Contingent legal liabilities (CLL) include accrued liabilities pertaining to legal cases where the Office of General Counsel (OGC) or the Office of Judge Advocate General (OJAG) consider an adverse decision probable and the amount of the loss measurable. Also disclosed are those cases in which an adverse decision is determined to be reasonably possible. In accordance with SFFAS 4 and SFFAS 5 as amended by SFFAS 12, management is responsible for reporting and/or disclosing liabilities related to ongoing legal matters.

During FY20, the OGC and OJAG offices executed a 100% review of case information for accuracy. As a result of that effort, Navy legal counsel updated legal records for financial reporting purposes, including closing cases that were no longer active, providing a likelihood of loss for each case, validating the claim amounts, and providing estimated loss assessments where applicable. However, the Navy's controls are not operating effectively to ensure that the estimates reported and disclosed are based on accurate information. Specifically, review controls are not sufficient to validate that the claim amounts used in the calculation of the estimates are based on accurate and updated information from OGC and OJAG. In addition, the current process documentation does not reflect the end-to-end procedures for the CLL process as a whole, including the identification of all key controls. The Navy plans to implement updated controls around accuracy of case information at both the legal and FMO levels, which will be critical in maintaining the progress achieved in FY20.

Recommendations

Consider the following corrective actions related to the conditions described above:

- In order to determine an appropriate loss assessment or range of loss for reporting purposes, OGC and the OJAGs should refine the quarterly control over the review of their case listings to focus on the key financial reporting elements, validate that case listing information is supported by case documents, and ensure that their review is evidenced. Specifically, evidence of review should include notes from the reviewer annotating any differences identified, amounts and other data validated, and action taken to resolve discrepancies.
- FMO should design controls that require special consideration of the amounts reported and disclosed for those cases that are individually material, assessed as probable or reasonably possible, inestimable, and/or unique in nature.
- FMO should implement a review control over historical payment data information received from OGC and the OJAGs to ensure that the information used in the calculation of the estimates is accurate. FMO should perform procedures to assess the financial statement impact when standard percentages are applied to claim amounts for estimation purposes.
- Document and communicate the end-to-end process for the entire lifecycle of CLL, including the initiation, recording, processing and reporting of transactions, and ensure all key controls, process owners, data interfaces, and federal regulations are outlined.

Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements,* the financial statements of the General Fund of the United States Navy (Navy), which comprise the consolidated Balance Sheet as of September 30, 2020, and the related consolidated Statements of Net Costs, Changes in Net Position, and the combined Statement of Budgetary Resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 15, 2020. Our report disclaims an opinion on such financial statements because the Navy was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of the Navy, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements as well as the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Our Report on Internal Control over Financial Reporting dated December 15, 2020, includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations to the specific issues presented.

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

FFMIA

Under FFMIA, we are required to report whether the Navy's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which the Navy's financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in the Fiscal Year (FY) 2020 Department of Navy Statement of Assurance, the Navy identified that financial systems and financial portions of mixed systems do not substantially meet the requirements of FFMIA or OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (Circular A-123) Appendix D.

EY also identified this material weakness as part of the Financial Information Systems material weakness, contained in the Report on Internal Control over Financial Reporting, where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with access controls, segregation of duties, configuration management, and interface processing. These financial system deficiencies prevent the Navy from being compliant with federal financial management system requirements and inhibit the Navy's ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2020 Department of Navy Statement of Assurance and Note 1 to the financial statements, the Navy identified that the design of financial and non-financial systems does not allow the Navy to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual accounting basis. EY also identified noncompliance with federal accounting standards during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2020 Department of Navy Statement of Assurance, the Navy identified that the design of financial systems does not allow the Navy to comply with USSGL at the transaction level. EY also identified noncompliance with USSGL posting logic during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* (commonly referred to as the GAO Green Book), issued under the authority of FMFIA, establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. To determine if an entity's internal control system is effective, the Green Book requires management to assess the design, implementation, and operating effectiveness of the five components of the entity's internal control system.

The Navy has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book requirements, leading to inadequate control environment, risk assessment and monitoring processes.

Management's Response to Findings

Navy's responses to the findings identified in our engagement and relevant comments from the Navy's management responsible for addressing the noncompliance are provided in their accompanying letter dated December 15, 2020. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the entity's compliance. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

December 15, 2020

RESPONSE TO INDEPENDENT AUDITORS' REPORT

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

December 15, 2020

Ernst & Young, LLP
(Attention: Mr. John F. Short, Partner)
1775 Tysons Boulevard
Tysons, VA 22102

Dear Mr. Short:

We reviewed the U.S. Navy General Fund Audit Report prepared by Ernst & Young, LLP for the audit of the U.S. Navy General Fund and appreciate the recommendations to continue improving our financial operations. The Navy acknowledges and concurs with the material weaknesses and disclaimer of the opinion.

The ongoing Coronavirus 2019 pandemic presented many unforeseen obstacles to the audit. We appreciate your flexibility in continuing the execution of audit procedures during Fiscal Year (FY) 2020 in spite of these obstacles. The lessons learned from the audit, and the recommendations provided within the report, will continue to improve our ability to support the future audits.

The Department of the Navy's (DON) financial management transformation strategy is built around three complementary elements: audit, budgetary reform, and consolidation of systems. In FY20, we downgraded the Contingent Legal Liabilities material weakness. We also developed the Navy Audit Roadmap to document key milestones and tasks necessary to resolve our material weaknesses and achieve an unmodified audit opinion by FY27. This integrated strategy will ensure we stay focused on the activities required to meet that long-term goal. Each year, we will sustain improvements and continue building on milestones achieved. FY21 priorities include:

- Ordnance – demonstrate accountability over existence and completeness of these assets and components;
- Environmental and Disposal Liabilities – fully support estimation methodologies, implement internal controls, and correct inaccurate balances;
- Budget Execution – improve the end-to-end budget process to include oversight of obligations and expenditures, timely recordation, and funds control;
- Real Property (Utilities) – demonstrate internal controls over the existence and completeness of utilities and plant components;
- Fund Balance with Treasury – sustain progress made to reduce suspense and statement of differences balances, and establish a standard DON-wide reconciliation process to produce an auditable trial balance;
- Financial Reporting – implement internal controls over estimates, accruals, and the reporting of asset balances; and
- Systems Consolidation – continue to consolidate legacy financial accounting and feeder systems into Navy Enterprise Resource Planning.

Findings from the annual financial statement audits are of enormous value to us. Returns through cost savings and cost avoidance enable re-investments in operational readiness that directly benefit our men and women serving aboard. We welcome your scrutiny and appreciate all you do to support us in the defense of our great nation.

Sincerely,

Alaleh A. Jenkins
Performing the Duties of the Assistant Secretary
of the Navy (Financial Management and Comptroller)

THIS PAGE INTENTIONALLY LEFT BLANK

An E-2C Hawkeye, from the "Sun Kings" of Carrier Airborne Early Warning Squadron (VAW) 116, is towed across the flight deck of the aircraft carrier USS Nimitz (CVN 68). (U.S. Navy photo by Mass Communication Specialist 3rd Class Elliot Schaudt/Released)

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

PRINCIPAL STATEMENTS

The FY 2020 DON WCF principal statements and related notes are presented in the format prescribed by OMB A-136, except as otherwise disclosed. The statements and related notes summarize financial information for individual funds and accounts within the DON WCF for the fiscal year ended September 30, 2020 and are not presented on a comparative basis.

The following section is comprised of the DON WCF principal statements and related notes:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement of Budgetary Resources
- Related Notes

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND
Consolidated Balance Sheet
As of September 30, 2020

($ in thousands)	Unaudited 2020
ASSETS (Note 2):	
Intragovernmental:	
Fund Balance with Treasury (Note 3)	$ 2,176,521
Accounts Receivable (Note 4)	1,058,084
Total Intragovernmental	**$3,234,605**
With the Public:	
Accounts Receivable, Net (Note 4)	5,894
Inventory and Related Property, Net (Note 5)	40,366,027
General Property, Plant and Equipment, Net (Note 6)	1,022,568
Other (Note 7)	343,523
Total with the Public	**41,738,012**
TOTAL ASSETS	**$ 44,972,617**
LIABILITIES (Note 8):	
Intragovernmental:	
Accounts Payable	$ 178,297
Other (Note 11)	486,220
Total Intragovernmental	**664,517**
With the Public:	
Accounts Payable	34,088
Federal Employee and Veteran Benefits (Note 9)	381,010
Environmental and Disposal Liabilities (Note 10)	46,722
Accrued Funded Payroll and Benefits	1,396,378
Other (Note 11)	803,602
Total with the Public	**2,661,800**
TOTAL LIABILITIES	**$ 3,326,317**
COMMITMENTS AND CONTINGENCIES (Note 12)	
NET POSITION:	
Unexpended Appropriations - Other Funds	$ 763,345
Cumulative Results of Operations - Other Funds	40,882,955
Total Net Position	**$ 41,646,300**
TOTAL LIABILITIES AND NET POSITION	**$ 44,972,617**

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Consolidated Statement of Net Cost

For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020
GROSS PROGRAM COSTS (Note 13):	
Gross Costs:	
Operations, Readiness & Support	$ 40,751,232
Less: Earned Revenue	(38,411,185)
NET COST OF OPERATIONS	$ 2,340,047

The accompanying notes are an integral part of these statements.

The Independence variant littoral combat ships USS Independence (LCS 2), left, USS Manchester (LCS 14), center, and USS Tulsa (LCS 16), right, sail in formation in the eastern Pacific. (U.S. Navy photo by Chief Mass Communication Specialist Shannon Renfroe/Released)

FINANCIAL SECTION DON WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Consolidated Statement of Changes in Net Position

For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020
UNEXPENDED APPROPRIATIONS:	
Beginning Balances	$ 7,666
BUDGETARY FINANCING SOURCES:	
Appropriations Transferred In/Out	1,351,500
Appropriations Used	(595,821)
TOTAL BUDGETARY FINANCING SOURCES	**755,679**
TOTAL UNEXPENDED APPROPRIATIONS	763,345
CUMULATIVE RESULTS FROM OPERATIONS:	
Beginning Balances	42,465,054
Prior Period Adjustments:	
Changes in Accounting Principles	(145,403)
BEGINNING BALANCES, AS ADJUSTED	**42,319,651**
BUDGETARY FINANCING SOURCES:	
Appropriations Used	595,821
Non-exchange Revenue	560
Transfers-in/out without reimbursement	88,000
OTHER FINANCING SOURCES (NON-EXCHANGE):	(595,821)
Transfers In/Out without Reimbursement	(1,135,010)
Imputed Financing	507,881
Other	846,099
TOTAL FINANCING SOURCES	**$ 903,351**
Net Cost of Operations (Note 13)	2,340,047
NET CHANGE	(1,436,696)
CUMULATIVE RESULTS OF OPERATIONS	$ 40,882,955
NET POSITION	$ 41,646,300

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

Combined Statement of Budgetary Resources

For the Fiscal Year Ended September 30, 2020

($ in thousands)	Unaudited 2020
BUDGETARY RESOURCES:	
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$ 3,789,765
Appropriations (discretionary and mandatory)	708,500
Contract Authority (discretionary and mandatory)	10,994,061
Spending Authority from Offsetting Collections (discretionary and mandatory)	23,216,183
TOTAL BUDGETARY RESOURCES	**$ 38,708,509**
STATUS OF BUDGETARY RESOURCES:	
New Obligations and Upward Adjustments (total)	$ 34,633,764
Unobligated Balance, End of Year:	
Apportioned, Unexpired Accounts	3,205,091
Exempt from Apportionment, Unexpired Accounts	1,696
Unapportioned, Unexpired Accounts	867,958
Unexpired Unobligated Balance, End of Year	4,074,745
Unobligated Balance, End of Year (total)	4,074,745
TOTAL BUDGETARY RESOURCES	**$ 38,708,509**
OUTLAYS, NET, and DISBURSEMENTS, NET	
Outlays, Net (total) (discretionary and mandatory)	$ 758,002
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	$ 758,002

The accompanying notes are an integral part of these statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.A. Reporting Entity

The DON WCF is a complex organizational entity comprised both of subordinate organizations, as well as other entities, which are administratively aligned to the USN mission, but funding for those operations is provided by external reporting entities.

For financial reporting purposes, the DON is organized into two reporting entities: the USN GF and the DON WCF. The DON WCF includes financial information for both the Navy and the Marine Corps. Each reporting entity has a separate set of financial statements and related disclosures. This section of the AFR specifically applies to the DON WCF, as a result, it does not disclose information related to the USN GF.

Refer to the MD&A Section – "Mission and Organization" for additional information.

1.B. Basis of Presentation and Accounting

These non-comparative financial statements reflect both proprietary and budgetary accounting transactions and are comprised of the consolidated balance sheet, consolidated statement of net cost, consolidated statement of changes in net position, and the combined statement of budgetary resources of the DON WCF. The DON WCF does not show comparative financial statements because financial statement line item values are changing due to remediation efforts and any comparison could be misleading to the reader. These financial statements have been prepared from the accounting records of the DON WCF in accordance with, to the extent possible, U.S. GAAP promulgated by the FASAB, OMB Circular A-136, Financial Reporting Requirements, Revised (August 2020) and the DoD, Financial Management Regulation (FMR).

Accounting standards require all reporting entities to disclose that certain presentations and disclosures can be modified, if needed, to prevent the disclosure of classified information.

The financial transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred, without regard to the timing of receipt or payment of cash. Whereas, under the budgetary basis, the legal commitment or obligation of funds is recognized in advance of the proprietary accruals and in compliance with legal requirements and controls over the use of federal funds.

The DON WCF is unable to implement all elements of U.S. GAAP, OMB A-136, and FFMIA due to limitations of financial and nonfinancial management processes and systems that support the financial statements. These limitations are noted throughout the financial statements as applicable.

The DON WCF derives reported values and information for major asset and liability categories from both financial and non-financial systems. The non-financial systems were designed primarily to support reporting requirements for maintaining accountability over assets rather than preparing financial statements in accordance with U.S. GAAP. The DON WCF continues to implement process and system improvements to address these limitations.

The financial statements are compiled from the underlying financial data and trial balances of the DON WCF's general ledger accounting systems. The underlying data is largely derived from budgetary transactions (e.g., obligations, disbursements, and collections), non-financial feeder systems, and accruals made for major items (e.g. payroll expenses, accounts payable, and FECA Liabilities). Some of the general ledger level trial balances may reflect abnormal balances resulting largely from faulty business and system processes and may not be evident within the financial statements. Disclosures of abnormal balances are made in the applicable footnotes, but only to the extent that the abnormal balances are evident at the consolidated/combined level.

The DON WCF is not in compliance with the following authoritative accounting guidance:

- SFFAS 1, "Accounting for Selected Assets and Liabilities"
- SFFAS 3, "Accounting for Inventory and Related Property"
- SFFAS 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government"
- SFFAS 5, "Accounting for Liabilities of the Federal Government"
- SFFAS 6, "Accounting for Property, Plant, and Equipment"
- SFFAS 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting"
- SFFAS 10, "Accounting for Internal Use Software"
- SFFAS 15, "Management's Discussions and Analysis"
- SFFAS 21, "Reporting of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources"
- SFFAS 29, "Heritage Assets and Stewardship Land"
- SFFAS 44, "Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use"
- SFFAS 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials"
- SFFAS 50, "Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35"
- SFFAS 53, "Budget and Accrual Reconciliation"
- SFFAS 55, "Amending Inter-entity Cost Provisions"
- Treasury Financial Manual (TFM)
- FFMIA of 1996
- GMRA of 1994

Certain disclosures related to the DoD CRE are not presented, including those required by the IPIA of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010 and the Improper Payments Elimination and Recovery Improvement Act of 2012; Section 3 of the OMB Memorandum 12-12, Promoting Efficient Spending to Support Agency Operations, and OMB Management Procedures Memorandum 2015-01, the Reduce the Footprint policy implementation guidance; Fraud Reduction Effort; and the OMB Management Procedures Memorandum 2016-04, GONE Act Reporting of Unclosed Grant and Cooperative Agreement Awards for which the period of performance has expired more than two years. These disclosures are presented in the DoD AFR on behalf of the USN.

1.C. Appropriations and Funds

The DON WCF received its initial funding through the establishment of a corpus which was provided through an appropriation. Annually, the DON WCF receives limited appropriated dollars and is primarily funded through contract authority, and spending authority from offsetting collections. Contract authority represents authority that permits the DON WCF to incur obligations. Spending authority from offsetting collection represent authority that permits obligations and outlays to be financed by offsetting collections.

The DON WCF obtains the goods and services sold to customers on a reimbursable basis in order to generate revenue, cover expenses, and maintains the corpus. Reimbursable receipts fund operations and generally are available in their entirety for use

without further congressional action. At various times, Congress provides additional appropriations to supplement the DON WCF as an infusion of cash when revenues are inadequate to cover costs within the corpus.

Refer to the MD&A Section – "Analysis of Financial Statements and Stewardship Information – DON WCF" for additional information related to the WCF direct appropriations received.

1.D. Use of Estimates

Preparation of the financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. As a result, actual results may differ from those estimates. Significant estimates and assumptions include, but are not limited to, plant replacement values for real property, general equipment including depreciation, OM&S, AFDA, payroll expenses, Accounts Payable, bulk obligations, inventory allowance, Contingent Legal Liabilities and unbilled revenue.

Due to existing system limitations, Navy is not consistently performing receipt and acceptance activities that would record Accounts Payables in the GL systems, or accruing for goods or services received but not invoiced or paid.

Significant estimates are not reasonable and supportable with the exception of Contingent Legal Liabilities.

1.E. Revenues and Other Financing Sources

The DON WCF recognizes revenue generated by the sales of goods and/or services and the costs incurred to provide those goods and services to other DoD entities, other federal agencies, and the public. Generally, the DON WCF is a revolving fund that relies on sales revenue rather than direct Congressional appropriations to finance its operations.

The DON WCF has four business areas: Depot Maintenance, Research and Development, Transportation, and Supply Management. [2]

- **Depot Maintenance** activities recognize revenue according to the percentage of completion method.
- **Research and Development** activities recognize revenue as actual costs are incurred and billed.
- **Transportation** activities recognize revenue on either a reimbursable or per diem basis. The majority of per diem projects are billed and collected in the month services are rendered. The remaining per diem projects recognize revenue in the month the services are rendered. For reimbursable projects, costs and revenue are recognized in the month services are rendered.
- **Supply Management** activities recognize revenue from the sale of inventory items.

The DON WCF recognizes revenue when earned within the constraints of its current system capabilities. In many instances, revenue is recognized when bills are issued and not when revenue is earned. The DON WCF does not include non-monetary support provided by U.S. allies for common defense and mutual security in amounts reported in the SNC and Note 16, "Reconciliation of Net Cost to Net Outlays." The U.S. has cost- sharing agreements with countries having a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. Fleet is in port.

The DON WCF records donations in trust funds and special funds as non-exchange revenue. The DON WCF recognizes non-exchange revenue when there is a specifically identifiable, legally enforceable claim to the cash or other assets of another party that will not receive value in return. Non-exchange revenue is not considered to reduce the cost of the DON WCF operations and is therefore reported in the SCNP as a financing source.

[2] With the transfer of the DON Real Property from the DON WCF to USN GF in FY 2020, the activities associated with Base Support operations are no longer performed under the DON WCF. Remaining unfilled customer orders for Base Support in the DON WCF will be closed out due to this transfer.

1.F. Recognition of Expenses

The DON WCF utilizes a combination of financial transactions within its accounting system and data calls to obtain and record financial amounts, including some expenses, which results in the untimely recording of some expense activity. Current financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis.

For OM&S, operating expenses are not always recognized when the items are consumed. Efforts are underway to transition to the consumption method to properly recognize expenses. Due to system limitations, the use of OM&S in constructing capital and other long-term assets may be recognized as operating expenses. The USN is implementing process and system improvements to fix these limitations.

1.G. Accounting for Intragovernmental Activities

The DON WCF cannot accurately identify intragovernmental transactions (e.g., revenues, expenses, accounts receivable, accounts payable, and non-expenditure transfers) by customer to properly eliminate intra-entity and trading partner activity and balances from the financial statements. The DON WCF's systems do not track buyer and seller data at the transaction level; thereby increasing the risk that all eliminating entries have not been recorded. Generally, seller entities within the DON WCF provide summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal accounting offices. In most cases, the buyer-side records are adjusted to agree with the DON WCF's seller-side balances and are then eliminated. The DON WCF continues to implement process and system improvements to address these limitations that will enable the DON WCF to correctly report, reconcile, and eliminate intragovernmental balances.

1.H. Fund Balance with Treasury

The DON WCF monetary resources are maintained in Treasury accounts. The DON WCF generally does not maintain cash in commercial bank accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the DON WCF, other military departments, and Department of State (State) financial service centers process the majority of the DON WCF's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports for the Treasury on checks issued, electronic fund transfers, interagency transfers, and deposits. The disbursing station monthly reports are consolidated at the disbursing office level for financial reporting purposes. In Fiscal Year 2020, the USN in partnership with DFAS, implemented Treasury Direct Disbursing (TDD) for a portion of vendor payments. TDD is the process of utilizing Treasury as a service provider to process disbursements, thereby eliminating the requirements for disbursing stations to prepare monthly reports for Treasury in order to report fund balance activity. Implementation of TDD resulted in USN having a blended disbursing environment, where both Non-Treasury Disbursed and TDD processes support the generation of disbursement transactions affecting fund balance.

In addition, DFAS and the U.S. Army Corps of Engineers (USACE) Finance Center submit reports to the Treasury by appropriation on interagency transfers, collections received, and disbursements issued. The Treasury records these transactions to the applicable FBwT account. On a monthly basis, the DON WCF's FBwT is reviewed and adjusted at the Department level within the DoD's Defense Departmental Reporting System-Budgetary (DDRS-B). FBwT variances identified after the GL systems have closed each month are addressed through adjustments entered during the financial reporting process in DDRS to record undistributed disbursements and collections. These adjustments, if required, help to ensure the DON WCF's financial statements agree with the Treasury accounts.

Refer to Note 3, "Fund Balance with Treasury," for additional information.

1.I. Accounts Receivable

Accounts Receivable, inclusive of claims receivable and refunds receivable, consists of amounts owed to the DON WCF by other Federal agencies and the public. The DON WCF estimates losses due to uncollectible non-federal amounts based on Accounts Receivable debt type depending on delinquency age. The DON WCF uses non- intragovernmental data to

age receivables based on an analysis of field-level Accounts Receivable detail reports to determine collectability of each aging category that is less than 150 days delinquent. Additionally, the DON WCF recognizes an allowance for all non-intragovernmental Accounts Receivable that are 150 days delinquent.

Gross receivables must be reduced to net realizable value by an allowance for doubtful accounts. FASAB Technical Bulletin 2020-1 clarifies that SFFAS 1 standards, including recognition of losses, apply to receivables from federal and non-federal entities. Currently, the USN GF/DON WCF is not fully compliant with the aforementioned authoritative guidance. The USN GF/DON WCF does not calculate an intragovernmental receivables loss allowance.

Refer to Note 4, "Accounts Receivable, Net" for additional information.

1.J. Inventory and Related Property

The DON WCF categorizes Inventory and Related Property as inventory and OM&S. Due to long standing business processes and financial system deficiencies, the DON WCF is unable to make an unreserved assertion for inventory and OM&S opening balances accounted for in legacy systems. The DON WCF accounts for OM&S using a combination of the consumption method and purchase method.

Supply management inventory is tangible personal property that is available and purchased for resale, held in reserve for future sale, held for repair, in development, and EOU. The DON WCF assigns inventory to categories based upon condition of the inventory item and based upon stage of fabrication.

The DON WCF values available and purchased for resale inventory using the MAC method. The DON WCF values held for repair inventory at the price of a serviceable item, less estimated repair costs, using the direct method. As the DON WCF completes the repair, the cost of repair is capitalized in the asset account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.

The DON WCF identifies related property as OM&S categorized as operating material and supplies held for use, held in reserve for future use, held for repair, and in development. The DON WCF holds OM&S based on military/mission need and support for contingencies.

The DON WCF standard valuation method for OM&S is MAC.

Refer to Note 5, "Inventory and Related Property, Net" for additional information.

1.K. General Property, Plant, and Equipment

Due to long standing business process and financial system deficiencies, the DON WCF is unable to make an unreserved assertion for GPP&E opening balances accounted for in legacy systems. As the DON WCF continues to implement sustainable go-forward GAAP-compliant processes, the DON WCF is working to establish opening balances for assets.

Currently, the DON WCF uses estimated historical cost for valuing GPP&E. To establish a baseline, the DON WCF accumulated information relating to program funding and associated equipment, equipment useful life, program acquisitions, and disposals. The equipment baseline was updated using expenditure, acquisition and disposal information.

The DON WCF does not yet utilize the account for assets awaiting disposal. Partial asset impairment is not a common occurrence in the DON WCF, as assets are either repaired to restore lost utility or removed from service. However, the DON WCF will recognize impairments for classes of assets or locations in the case of major events, (e.g., natural disasters) or if the impairment affects an entire class of assets.

The DON WCF capitalizes GPP&E at historical acquisition cost when an asset has a useful life of two or more years and when the acquisition cost equals or exceeds capitalization thresholds. The DON WCF capitalizes improvements to existing GPP&E if the improvement equals or exceeds the DON WCF's capitalization threshold, extends the useful life of the underlying asset, or increases asset size, efficiency, or capacity. The DON WCF depreciates all GPP&E, on a straight-line basis.

The DON WCF uses several capitalization thresholds for its GPP&E. For all general fund assets acquired or developed after June 30, 2013, the DON WCF uses a $1.0 million threshold for general equipment. In FY 2020, Navy changed the acquisition threshold for real property from $250 thousand to $1.0 million. Once an asset is identified as capital, it remains on the books even if they do not meet current thresholds. Due to business process and system limitations, the DON WCF does not currently report accurate values related to IUS.

When it is in the best interest of the government, the DON WCF provides government property to contractors to complete contract work. The DON WCF owns such property and either provides it to the contractor or it is purchased directly by the contractor from the government based on contract terms. The FAR requires the DON WCF to maintain information on all property furnished to contractors in the DON WCF property systems. The Navy reports such property when the value of contractor- procured GPP&E meets or exceeds the DON WCF capitalization thresholds. In addition, federal accounting standards require that this contractor held property be reported on the DON WCF balance sheet. The DON WCF is not in compliance with the FAR or federal accounting standards and is in the process of implementing business process and system improvements to do so.

1.L. Advances and Prepayments

When making payments in advance of the receipt of goods and services is permitted by law, legislative action, or Presidential authorization, the DON WCF's policy is to record advances or prepayments as an asset on the Balance Sheet. Upon receipt of the related goods and services, the DON WCF's policy is to reduce the advances and prepayments and properly classify the assets. Advances and prepayments received are recorded as liabilities. The DON WCF has not implemented this policy due to noncompliance with the FFMIA.

1.M. Other Assets

Other assets include civil service employee pay advances, travel advances, and certain contract financing payments not reported elsewhere on the DON WCF's Balance Sheet.

- **Advances** are cash outlays made by the DON WCF to its employees, contractors, or others to cover part or all the recipients' anticipated expenses.
- **Civilian pay advances** are payments advanced to full-time DON WCF civilians intended to finance unusual employee expenses associated with oversea assignments that are not otherwise reimbursed and to aid foreign assignment recruitment and retention. Travel advances are disbursed to employees prior to business trips and the travel advance is subsequently reduced when travel expenses are incurred.
- **Financing payments** allow the DON WCF to alleviate the potential financial burden that long-term contracts can cause to a contractor. Contract financing payment clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advances and interim payments, progress payments based on costs, and interim payments under certain cost-reimbursement contracts.
  - **Contract financing payments** do not include invoice payments, payments for partial deliveries, or lease and rental payments.
  - **Progress payments** are only authorized based on a percentage or stage of completion and only for construction of real property; shipbuilding; and ship conversion, alteration, or repair. Progress payments based on percentage or stage of completion are reported as CIP.

1.N. Environmental and Other Contingent Liabilities

A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity. Contingent liabilities are recognized when a past event or exchange transaction has occurred, and a future outflow of resources is probable and measurable. A contingency is considered probable when the future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, a contingency is considered probable when the future confirming event or events are likely to occur. A contingency is disclosed in the Notes to the Financial Statements if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. A contingency is considered reasonably possible when the chance of the future confirming event or events occurring is more than remote but less than probable. A contingency is not recognized as a contingent liability and an expense nor disclosed in the Notes to the Financial Statements when the chance of the future event or events occurring is remote. A contingency is considered remote when the chance of the future event or events occurring is slight.

Contingent legal liabilities are calculated based on a predetermined estimation methodology. Navy FMO will use OGC and Office of the Judge Advocate General (OJAG) attorney's likelihood assessment to categorize the cases for appropriate accounting treatment. Currently there is no OJAG related cases in the DON WCF. The estimation methodology is based on the OGC attorney's claim amount assessments and historical payout data applied to specific claim amounts.

Refer to Note 12, "Commitments and Contingencies" for additional information.

Environmental and Disposal Liabilities (E&DL) are estimates for anticipated environmental clean-up or environmental disposal costs. The DON WCF reports E&DL by estimating environmental clean-up (i.e., environmental restoration) or disposal costs for hazardous waste associated with future closure of GPP&E assets.

The other accrued environmental restoration costs do not include the costs of environmental compliance, pollution prevention, conservation activities, contamination, or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations.

Refer to Note 10, "Environmental and Disposal Liabilities" for additional information.

1.O. Accrued Leave

The DON WCF reports compensatory and civilian annual leave as accrued liabilities as it is earned. The accrued balance is adjusted at least quarterly to reflect current pay rates and unused hours of leave. Any portions of the accrued leave for which funding is not available, are recorded as an unfunded liability. Sick leave for civilians is expensed as taken.

1.P. Net Position

Net position consists of Unexpended Appropriations and Cumulative Results of Operations. Unexpended Appropriations represent the amount of budget authority that is unobligated and has not been rescinded or withdrawn, as well as amounts obligated for which a legal liability for payment has not been incurred.

Cumulative Results of Operations represent the net difference between expenses and losses, and financing sources including appropriations, revenue, and gains, since inception. The Cumulative Results of Operations also include donations and transfers in and out of assets that were not reimbursed.

1.Q. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections recorded in the general ledger and those reported by the Treasury. Due to the nature of undistributed, there is a possibility both supported and unsupported adjustments may have been made to the DON WCF Accounts Payable and Accounts Receivable prior to validating underlying transactions.

Due to noted material weaknesses in current accounting and financial feeder systems, the USN generally cannot determine whether undistributed disbursements and collections should be applied to federal or non-federal Accounts Payable or Accounts Receivable at the time accounting reports are prepared. The USN follows the DoD policy to allocate supported undistributed disbursements and collections between federal and non-federal categories based on the percentage of distributed federal and non-federal Accounts Payable and Accounts Receivable. Unsupported undistributed disbursements and collections are applied to reduce Accounts Payable and Accounts Receivable accordingly.

Refer to Note 3, "Fund Balance with Treasury" for additional information.

1.R. Federal Employee and Veteran Benefits

Refer to Note 9, "Federal Employee and Veteran Benefits" for additional information.

1.S. Tax Exempt Status

As an agency of the federal government, the DON WCF is exempt from all income taxes imposed by any governing body whether it is a federal, state, commonwealth, local, or foreign government.

An F/A18F Super Hornet attached to the "Fighting Swordsmen" of Strike Fighter Squadron (VFA) 32, takes off from the flight deck.
(U.S. Navy photo by Mass Communication Specialist 2nd Class Gian Prabhudas)

NOTE 2. NON-ENTITY ASSETS

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Assets	
Accounts Receivable	$ 987
Non-Federal Assets	
Accounts Receivable	7,056
TOTAL NON-ENTITY ASSETS	**8,043**
TOTAL ENTITY ASSETS	**44,964,574**
TOTAL ASSETS	**$ 44,972,617**

Non-entity Assets are assets held by the DON WCF but are not available for the DON WCF.

Non-Federal Accounts Receivable with the Public represents interest, penalties, fines and administrative fees that will be remitted to the Treasury's Miscellaneous Receipts account.

Aviation Airmen clean the canopy of a F/A-18E Super Hornet on the flight deck
of the Navy's only forward-deployed aircraft carrier USS Ronald Reagan (CVN 76).
(U.S. Navy photo by Mass Communication Specialist 3rd Class Erica Bechard/Released)

NOTE 3. FUND BALANCE WITH TREASURY

As of September 30 ($ in thousands)	Unaudited 2020
Status of Fund Balance with Treasury	
Unobligated Balance:	
Available	$ 3,206,787
Unavailable	867,958
Total Unobligated Balance	**4,074,745**
Obligated Balance not yet Disbursed	**19,409,462**
Non-FBwT Budgetary Accounts:	
Unfilled Customer Orders without Advance	(12,188,485)
Contract Authority	(8,093,137)
Receivables and Other	(1,026,064)
Total Non-FBwT Budgetary Accounts	**(21,307,686)**
Total Fund Balance with Treasury	**$ 2,176,521**

The Status of FBwT reflects the budgetary resources to support the FBwT and is a reconciliation between budgetary and proprietary accounts. The balances reflect the budgetary authority remaining for disbursement against current and future obligations.

Unobligated Balances are classified as available or unavailable and represent the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Certain unobligated balances may be restricted for future use and are not apportioned for current use. The Navy has not identified any such restricted balances.

Obligated Balance not yet Disbursed represents funds obligated for goods and services but not paid.

Non-FBwT Budgetary Accounts are required to reconcile the budgetary status to non-budgetary FBwT, as reported in the balance sheet. Non-FBwT budgetary accounts create contract authority and unobligated balances, but do not post to FBwT as there is no receipt of cash. The Non-FBwT budgetary accounts are comprised of contract authority, accounts receivable, and unfilled orders without advance from customers.

Other Additional Information

The DON WCF field-level general ledger accounting systems may not include all Treasury collection and disbursement activity for reasons such as timing differences, transaction distribution errors, and disbursements made by other DoD agencies on behalf of the DON WCF. Thus, the fund balance per the DON WCF includes undistributed disbursements and collections, representing the difference between disbursement and collections recorded with Treasury and those balances recorded within the DON WCF general ledgers. The DON WCF recorded $317.0 million in undistributed disbursements and $297.0 million in undistributed collections as of September 30, 2020.

NOTE 4. ACCOUNTS RECEIVABLE, NET

As of September 30 ($ in thousands)	Unaudited 2020		
	Gross Amount Due	Allowance for Uncollectible Accounts	Accounts Receivable, Net
Intragovernmental Receivables	$ 1,058,084	$ —	$ 1,058,084
Non-Federal Receivables (With the Public)	67,813	(61,919)	5,894
Total Accounts Receivable	**$ 1,125,897**	**$ (61,919)**	**$ 1,063,978**

Accounts Receivable, Net represents the DON WCF's claim for payment from federal and non-federal sources.

Intragovernmental Receivables primarily represent amounts due from other federal agencies for reimbursable work performed pursuant to the Economy Act and other statutory authority. Seller-side accounts receivable are adjusted to agree with inter-/intra-agency buyer-side's accounts payable through the DON WCF's elimination process when buyer-side balances are deemed more reliable.

Non-federal Receivables (With the Public) are primarily held with CNIC (NAVFAC) and NAVSUP. These balances, once collected, may be used by the collecting agency based upon nature of Accounts Receivable.

The DON's gross amount due for Non-federal Receivables (With the Public) include amounts related to criminal restitution owed to the government. In FY 2020, accounts receivable, net included $0.6 million of gross receivable related to criminal restitution orders monitored by DFAS, of which no collections are expected to be made as debts are more than two years delinquent.

Restitution receivables and associated payments are pursued by the courts handling those cases. Receivables are established based on the court documents received and posts payments received through the courts. At two years delinquent, criminal restitution receivables are considered 100 percent uncollectible; however, the DON is only authorized to write off or close accounts with approval from the Department of Justice.

Due to limitations of financial and nonfinancial management processes and systems that support the financial statements, the DON is unable to separately identify the USN GF and the DON WCF criminal restitution receivables.

Refer to Note 1.I, "Accounts Receivable" for additional information.

NOTE 5. INVENTORY AND RELATED PROPERTY, NET

As of September 30 ($ in thousands)	Unaudited 2020
Inventory, Net	$ 40,095,436
Operating Material & Supplies, Net	270,591
Total Inventory and Related Property, Net	**$ 40,366,027**

INVENTORY, NET

As of September 30 ($ in thousands)	Unaudited 2020			
	Inventory, Gross Value	Revaluation Allowance	Inventory, Net	Valuation Method
Inventory Categories				
Available and Purchased for Resale	$ 21,647,065	$ (413,205)	$ 21,233,860	MAC
Held in Reserve for Future Sale	734,002	—	734,002	MAC
Held for Repair	17,399,137	(9,225)	17,389,912	MAC
In Development	737,662	—	737,662	MAC
Excess, Obsolete, and Unserviceable	18,538	(18,538)	—	NRV
Total	**$ 40,536,404**	**$ (440,968)**	**$ 40,095,436**	

Legend for Valuation Methods:
MAC = Moving Average Cost NRV = Net Realizable Value

The DON WCF inventory consists of funded and reported materials held for sale or as inventory stock, under the DON WCF. All the USN inventory held for sale is funded and reported on the DON WCF financial statements.

The DON WCF classifies its inventory into five categories based on purpose or condition: available and purchased for resale, held in reserve for future sale, held for repair, work in process, and EOU.

Available and Purchased for Resale inventory is defined as inventory held for sale, used in the process of production for sale, or to be consumed in the production of goods for sale or in the provision of services for a fee. Available and purchased for resale inventory includes consumable and reparable spare and repair parts and repairable items owned and managed by the DON WCF. Available and purchased for resale also include items for sale or transfer to entities outside the federal government or other federal entities. The DON WCF recognizes inventory when title passes to the DON WCF or when the goods are delivered to the DON WCF.

Held in Reserve for Future Sale inventory consists of additional consumable and repairable items held in reserve for future sale as it is not readily available for immediate sale.

Held for Repair inventory consists of damaged materiel that requires repair to make it usable.

With the category of held for repair, the inventory items here are initially presented at purchase value (gross value). This value is used to reconcile inventory listings and related reports. The internally calculated revaluation allowance is then factored to bring the inventory to its net cost. Revaluation allowances usually arise from destroyed goods, missing goods, or a decrease in the market value of goods.

As a result of business processes and system limitations, the revaluation allowance is recorded to eliminate unreconciled balances between the USN APSRs and logistics feeder systems.

In Development consists of partially finished goods still in the production process that has not yet been completed; including direct material, direct labor, applied overhead, and other direct costs.

Excess, Obsolete and Unserviceable inventory consists of items that exceeds the amount expected to be used; is no longer needed because of changes in technology, laws, customs, or operations; or is damaged physically and cannot be consumed in operations.

EOU WCF inventory is to be valued at net realizable value. The DON estimates an NRV equal to zero ($0) for all EOU WCF inventory assets due to disposition. Disposition of EOU WCF inventory includes DLA Disposition Services (DLADS), Donations and Transfers to Government Agencies. The DON's valuation of EOU WCF is not in compliance with SFFAS 3.

Revaluation allowances usually arise from destroyed goods, missing goods, or a decrease in the market value of goods. Currently, DON WCF inventory revaluation allowance is not in compliance with SFFAS 3.

There are currently no restrictions on the use, sale, or disposition of inventory except in the following situations: 1) distributions without reimbursement are made when authorized by DoD directives; 2) war reserve materiel includes repair items that are considered restricted; and 3) inventory, except for safety stocks, may be sold to foreign, state, and local governments; private parties; and contractors in accordance with current policies and guidance or at the direction of the President.

OPERATING MATERIALS AND SUPPLIES, NET

As of September 30 ($ in thousands)	Unaudited 2020			
	Gross Value	Revaluation Allowance	Net	Valuation Method
OM&S Categories				
Held for Use	$ 270,229	$ —	$ 270,229	MAC
Held in Reserve for Future Use	287	—	287	MAC
In Development	75	—	75	MAC
Total	**$ 270,591**	**$ —**	**$ 270,591**	

Legend for Valuation Methods:
MAC = Moving Average Cost

The DON WCF OM&S consists of tangible personal property in support of general maintenance on Navy facilities such as paint, screws, bolts, etc. The DON WCF OM&S is classified in the following categories based on purpose or condition:

Held for Use consists of all other serviceable (ready for issue) material.

Held in Reserve for Future Use consists of operating materials and supplies, held in reserve because they are not readily available or there is a more than a remote chance that they will be needed for future use. OM&S materials held for repair are reported under held in reserve for future use.

In Development are costs incurred in developing the OM&S or the value of tangible personal property that will be consumed in normal operations upon completion of development.

There are no known restrictions on the use of OM&S.

NOTE 6. GENERAL PROPERTY, PLANT AND EQUIPMENT, NET

As of September 30 ($ in thousands)	Unaudited 2020				
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value
Major Asset Classes					
Buildings, Structures and Linear Structures	S/L	35, 40 or 45	$ 100,591	$ (75,690)	$ 24,901
Software	S/L	2-5 or 10	172,523	(133,212)	39,311
General Equipment	S/L	Various	3,070,616	(2,513,860)	556,756
Construction-in-Progress	N/A	N/A	401,600	—	401,600
Total General PP&E			**$ 3,745,330**	**$ (2,722,762)**	**$ 1,022,568**

Legend for Depreciation/Amortization Method:
N/A = Not Applicable S/L = Straight Line

The DON WCF's GPP&E is comprised of unique asset lifecycle-based categories consisting of: real property (buildings, structures, linear structures and utilities); IUS; General Equipment; and CIP (real property and general equipment).

There are no known restrictions on the use or convertibility of general PP&E.

Refer to Note 1.K, "General Property, Plant, and Equipment" for additional information.

As of FY 2020, Navy implemented the Office of the Secretary of Defense (OSD) Real Property Financial Reporting Responsibilities (FRO) Policy Update, dated March 15, 2019. The policy requires the USN GF financial statements recognize all the DON WCF real property assets (i.e., building, land, structures, and linear structures) located and aligned to Navy installations. This includes the recognition of any capital improvements associated with DoD-owned assets. The DON WCF will continue to report to USN GF instances that they are the installation host, real property assets that are on other federal agency installations or land or private property sites, and leased facilities and the associated improvements that are not on DoD land, if applicable.

NOTE 7. OTHER ASSETS

As of September 30 ($ in thousands)	Unaudited 2020
Non-Federal Other Assets	
Outstanding Contract Financing Payments	$ 69,328
Advances and Prepayments	271,984
Other Assets (With the Public)	2,211
Total Non-Federal Other Assets	**343,523**
Total Other Assets	**$ 343,523**

Non-Federal Outstanding Contract Financing Payments consist of contract terms and conditions for certain types of contract financing payments that convey rights to the USN, protecting the contract work from state or local taxation, liens or attachment by contractors' creditors, transfer of property, or disposition in bankruptcy. However, these rights do not mean that ownership of the contractor's work has transferred to the USN. The USN does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the DON WCF is not obligated to make payment to the contractor until delivery and acceptance. These cash outlays and payments are made by the DON WCF to contractors, grantees, or others to cover the recipients' anticipated and periodic expenses before those expenses are incurred. OCFP are reduced when goods and services are received, contract terms are met, progress is made on a contract, or prepaid expenses expire.

Non-Federal Advances and Prepayments are cash outlays made by a federal entity to cover a part or all of the recipients' anticipated expenses or as advance payments for the costs of goods and services the entity will receive. Prepayments are payments made to cover certain periodic expenses before those expenses are incurred.

Non-Federal Other Assets (With the Public) consists of prepayments made to vendors and travel advances made to employees.

Construction Battalion (NMCB) 4, place straps around a landing roller cross girder to lift it off the bridge.
(U.S. Navy photo Construction Electrician Constructionman Alexzander Petitt/Released)

NOTE 8. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Liabilities	
Other	$ 74,801
Total Intragovernmental Liabilities	**74,801**
Non-Federal Liabilities	
Federal Employee and Veteran Benefits	381,010
Environmental and Disposal Liabilities	46,722
Other	2,619
Total Non-Federal Liabilities	**430,351**
Total Liabilities Not Covered by Budgetary Resources	**505,152**
Total Liabilities Covered by Budgetary Resources	**2,821,165**
Total Liabilities	**$ 3,326,317**

Intragovernmental Other primarily consist of unfunded FECA liabilities due to DOL and unemployment compensation due to applicable states. These liabilities will be funded by future years' budgetary resources.

Federal Employee and Veteran Benefits consist of various employee actuarial liabilities not due and payable during the current fiscal year.

Environmental and Disposal Liabilities are estimates related to future events, and consist of liabilities related to active installations, and disposal of equipment and weapons programs.

Refer to Note 10, "Environmental and Disposal Liabilities," for additional information.

Liabilities not Covered by Budgetary Resources includes liabilities for which congressional action is needed before budgetary resources can be provided to cover the liabilities. These include liabilities resulting from the receipt of goods or services in the current or prior periods, or the occurrence of eligible events in the current or prior periods, for which revenues or other sources of funds necessary to pay the liabilities have not been made available through congressional appropriations or earnings of the entity.

Liabilities Covered by Budgetary Resources includes Accounts Payable amounts owed to federal and non-federal entities for goods and services received by the USN. The USN's systems do not track intragovernmental accounts payable transactions by customer. As a result, in the intragovernmental eliminations process, buyer-side accounts payable are adjusted to agree with inter/intra-agency seller-side accounts receivable. The USN's methodology for adjusting Accounts Payables consist of (1) reclassifying amounts between federal and non-federal Accounts Payable and (2) applying both supported and unsupported undistributed disbursements at the reporting entity level.

Refer to Note 1.Q, "Undistributed Disbursements and Collections" for additional information.

NOTE 9. FEDERAL EMPLOYEE AND VETERAN BENEFITS

As of September 30 ($ in thousands)	Unaudited 2020		
	Liabilities	(Assets Available to Pay Benefits)	Unfunded Liabilities
Other Benefits:			
Federal Employees' Compensation Act	$ 381,010	$ —	$ 381,010
Total Federal Employee and Veteran Benefits	**$ 381,010**	**$ —**	**$ 381,010**

The DON WCF reports an actuarial liability for the FECA. The FECA provides federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation.

FECA amounts consist of amounts for federal employees injured in the performance of duty with workers' compensation benefits, which include wage-loss benefits for total or partial disability, monetary benefits for permanent loss of use of a schedule member, medical benefits, and vocational rehabilitation. FECA also provides survivor benefits to eligible dependents if the injury causes the employee's death. FECA is administered by the Office of Workers' Compensation Programs. The obligations and liabilities for pensions, military retirement health benefits, military Medicare-eligible retiree benefits, the Voluntary Separation Incentive Program, and the DoD Education Benefits Fund are reported at the Department level.

Actuarial Cost Method Used and Assumptions

The USN's actuarial liability for workers' compensation benefits is developed by DOL and is provided to the USN only at the end of each fiscal year. The estimate for future workers' compensation benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims.

DOL calculates the future workers' compensation liability using wage inflation factors (e.g., COLAs) and medical inflation factors (e.g., CPIM). The actual rates for these factors for CBY 2020 were also used to adjust the methodology's historical payments to current year constant dollars.

To test the reliability of the model discussed above, DOL made comparisons between projected payments in the last year to actual amounts, by agency. Year over year changes in the liability were also examined, with any significant agency-level differences inspected in greater detail. DOL concluded that the model has been stable and has projected each agency's actual payments well.

Consistent with past practice, these projected annual benefit payments have been discounted to present value based on interest rate assumptions on the U.S. Department of the Treasury's Yield Curve for Treasury Nominal Coupon Issues (the TNC Yield Curve) to reflect the average duration of income payments and medical payments. An interest rate for wage benefits of 2.41% was assumed for year one and years thereafter. An interest rate for medical benefits of 2.30% was assumed for year one and years thereafter.

NOTE 10. ENVIRONMENTAL AND DISPOSAL LIABILITIES

As of September 30 ($ in thousands)	Unaudited 2020
Other Accrued Environmental Liabilities - Non-BRAC	
Environmental Closure Requirements	$ 25,915
Asbestos	20,677
Non-Military Equipment	130
Total Environmental and Disposal Liabilities	**$ 46,722**

The USN reports the estimated environmental clean-up or disposal costs for hazardous waste associated with future closure of GPP&E assets. Such costs are categorized as environmental corrective action, closure of facilities, remediation of operational range contamination, asbestos abatement, and disposal of non-military equipment. The remaining environmental liabilities are reported under the USN GF Financial Statements.

Applicable Laws and Regulations for Cleanup Requirements

The following is a list of significant laws that affect the DON WCF's conduct of environmental policy and regulations:

- SARA
- Clean Water Act
- Safe Drinking Water Act
- Clean Air Act
- Atomic Energy Act
- Nuclear Waste Policy Act
- Low Level Radioactive Waste Policy Amendments Act
- CERCLA
- Medical Waste Tracking Act
- Toxic Substances Control Act
- Resource Conservation and Recovery Act of 1976, as amended by the Hazardous and Solid Waste Amendments of 1984
- National Environmental Policy Act of 1969
- Medical Waste Tracking Act of 1988
- Financial Management Regulation Volume 4, Chapter 13: "E&DL" (2018), SFFAS 5: Accounting for Liabilities of the Federal government SFFAS 6: Accounting for Property, Plans, and Equipment, DoD FMR, Volume 6B, Chapter 10, Notes to the Financial Statements
- Federal Financial Accounting and Auditing TR 2, Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government Page 2 of 27
- Federal Financial Accounting TR 10, Implementation Guidance on Asbestos Cleanup Costs Associated with Facilities and Installed Equipment
- Federal Financial Accounting TR 11, Implementation Guidance on Cleanup Costs Associated with Equipment
- Federal Financial Accounting TR 14, Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment

- FASAB Technical Bulletin 2006-1, Recognition and Measurement of Asbestos-Related Cleanup Cost, amended by FASAB under Technical Bulletin 2011-2, Extended Deferral of the Effective Date of Technical Bulletin 2006-1, Recognition and Measurement of Asbestos- Related Cleanup Costs

Types of Environmental and Disposal Liabilities Identified

Other Accrued Environmental Liabilities – Non-BRAC

The OEL segment prepares accounting estimates for the unique clean-up costs that will be incurred when the DON WCF GPP&E assets are decommissioned. The estimate is only prepared for those assets determined to have unique cleanup costs associated with hazardous waste or materials at the time of decommissioning. This includes estimates of environmental cleanup costs upon asset closure, addressing hazardous waste, asbestos, and lead, in addition to mandated cleanup of petroleum residuals and lubricants, these estimates are recognized as cleanup costs to current operating procedures. The OEL segment also reports estimated costs to remediate existing environmental damage at active DON WCF facilities, when such costs are not eligible for funding from DERP.

The DON WCF's estimated recognized environmental cleanup cost for GPP&E totaled $46.7 million as of September 30, 2020. For closure sites, non-military equipment and asbestos-abatement units placed in service after a threshold date, only part of estimated costs is immediately recognized as an environmental liability. The un-accrued portion of such estimates is reported as unrecognized costs. The DON WCF's unrecognized environmental cleanup cost for GPP&E totaled $3.3 million as of September 30, 2020.

For FY 2020, due to estimation uncertainties there is a possibility that environmental liabilities could increase to approximately $97 million, which also includes uncertainty concerning asbestos abatement.

As of September 30, 2020, the DON is in the process of capturing General Equipment captured outside of the Defense Property Accountability System (DPAS) and estimated a disposal liability for those assets which equates to a range of $3 million to $334 million. This range was determined to be immaterial to the Navy's financial statement.

Asbestos-Related Cleanup Costs

The Department maintains structures and facilities that may contain asbestos material in the construction or renovation. Due to asbestos being difficult to identify pre-construction or until demolition occurs the Navy does not conduct separate or distinct estimates for friable and non-friable asbestos. Once identified as containing or believed to contain asbestos, the Navy considers the entire property as requiring asbestos remediation upon demolition and disposal of the property.

Methods for Assigning Total Cleanup Costs to Current Operating Periods

When the environmental cost estimates are completed, the USN complies with accounting standards to assign cost to the current operating period through amortization.

Nature of Estimates and the Disclosure of Additional Information

Estimated environmental liabilities are extremely complex with various input factors. In addition, these input factors are adjusted for new technology, price growth (inflation), increases in labor rates and materials. As of September 30, 2020, there are no changes to the environmental liability estimates due to inflation, deflation, changes in laws, regulations, agreements with regulatory agencies, and advances in technology. The USN is not aware of any pending changes, but the liability can change in the future due to changes in laws and regulations, inflation, deflation, changes in agreements with regulatory agencies, and advances in technology.

NOTE 11. OTHER LIABILITIES

As of September 30 ($ in thousands)	Unaudited 2020		
	Current	Non-Current	Total
Intragovernmental			
Advances from Others	$ 310,960	$ —	$ 310,960
FECA Reimbursement to the DOL	34,003	40,798	74,801
Custodial Liabilities	8,043	—	8,043
Employer Contribution and Payroll Taxes	92,416	—	92,416
Total Intragovernmental Other Liabilities	**$ 445,422**	**$ 40,798**	**$ 486,220**
Non-Federal			
Advances from Others	517,288	—	517,288
Deferred Credits	198,198	—	198,198
Deposit Funds and Suspense Accounts	5,103	—	5,103
Contact Holdbacks	72,040	—	72,040
Employer Contribution and Payroll Taxes Payable	7,852	—	7,852
Contingent Liabilities	—	2,619	2,619
Other Liabilities	502	—	502
Total Non-Federal Other Liabilities	**$ 800,983**	**$ 2,619**	**$ 803,602**
Total Other Liabilities	**$ 1,246,405**	**$ 43,417**	**$ 1,289,822**

Intragovernmental Liabilities:

Intragovernmental Advances from Others represent liabilities for collections received to cover future expenses or acquisition of assets.

Intragovernmental FECA Reimbursement to the Department of Labor represents the liability chargeback amount for payments made by DOL on the behalf of the DON WCF.

Intragovernmental Custodial Liabilities represent liabilities for collections reported as non-exchange revenues where the DON WCF is acting on behalf of another federal entity. The Statement of Custodial Activity is not required as part of the DON WCF's financial statements as they are reflected on the DON WCF's Balance Sheet.

Intragovernmental/Non-Federal Employer Contribution and Payroll Taxes represents the employer portion of payroll taxes and benefit contributions for health benefits, retirement, life insurance, and voluntary separation incentive payments.

Non-Federal Liabilities:

Non-Federal Advances from Others represent liabilities for collections received from public to cover future reimbursable expenses.

Non-Federal Deposit Funds and Suspense Accounts represent advances or security deposits associated with closed orders in the process of being refunded to customers.

Non-Federal Contract Holdbacks consist of amounts withheld from payments to contractors to assure compliance with contract terms, usually expressed as a percentage in the respective contract provisions.

Non-Federal Contingent Liabilities include accrued contingent legal liabilities pertaining to pending legal cases where OGC consider an adverse decision probable and the amount of the loss measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Treasury Judgment Fund.

Non-Federal Other Liabilities are attributed to improperly record unfunded liability transactions in the field accounting system. The posting issues creating this condition have been documented to support identification and prioritization of corrective action.

Sailors maneuver a rigid-hull inflatable boat near the guided-missile destroyer USS Sterett (DDG 104) during small boat operations in the North Arabian Sea. (U.S. Navy photo by Mass Communication Specialist Seaman Drace Wilson)

NOTE 12. COMMITMENTS AND CONTINGENCIES

Commitments:

Commitments are preliminary actions that will ultimately result in an obligation to the U.S. government if carried through, such as purchase requisitions, estimated travel orders, or unsigned contracts/grants. The DON WCF is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may or may not result in a future outflow of expenditures. Currently, the DON WCF does not have a systemic process by which it captures or assesses these potential contingent liabilities. Therefore, the amounts reported may not fairly present the DON WCFs contingent liabilities.

Legal Contingencies:

The DON WCF is a party in various administrative proceedings, legal actions, and claims for environmental damage, employment matters, and contractual bid protests, which may ultimately result in settlements or decisions adverse to the federal government. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The OGC conducts reviews of litigation claims involving the DON WCF to which the OGC attorneys devoted substantial attention in the form of legal consultation or representation. The OGC assesses the likelihood of an unfavorable outcome as follows: probable, reasonably possible, or remote.

Probable Likelihood of an Adverse Outcome:

As of September 30, 2020, the DON WCF has an estimated potential loss of $2.6 million is assessed as probable if adverse decisions are made against the DON WCF. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is probable that an adverse outcome will result. The potential loss is reported as part of the Other Liabilities on the Balance Sheet. For certain claims that are paid by Treasury's Judgment Fund, which the DON WCF does not have to reimburse, an Imputed Financing Source is recognized. However, agencies are required to reimburse the Judgment Fund for payments pursuant to the Contract Disputes Act and the Notification and Federal Employees Antidiscrimination and Retaliation Act of 2002.

Refer to Note 11, "Other Liabilities," for additional information.

Reasonably Possible Probable Likelihood of an Adverse Outcome:

As of September 30, 2020, the DON WCF has an estimated potential loss of $8.8 million that is assessed as reasonably possible if adverse decisions are made against the DON WCF. There were cases with no estimable amount or range of loss that may result in potential loss. For these potential losses, it is reasonably possible that an adverse outcome will result.

FINANCIAL SECTION DON WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

NOTE 13. DISCLOSURES RELATED TO THE STATEMENT OF NET COST

Cost and Exchange Revenue

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental Costs	$ 7,209,413
Non-federal Costs	33,541,819
Total Cost	**40,751,232**
Intragovernmental Revenue	(28,399,276)
Non-federal Revenue	(10,011,909)
Total Revenue	**(38,411,185)**
Total Net Cost	**$ 2,340,047**

The SNC represents the net cost of programs and organizations of the DON WCF. The intent of the SNC is to provide gross and net cost information related to the amount of output or outcome for a given program or organization administered by a responsible reporting entity. The DON WCF non-federal gross costs balance within NERP overstates the costs of goods sold amounts related to assets returned by customers due to system limitations.

Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed by the DON WCF are recognized as imputed cost in the SNC and are offset by imputed revenue in the SCNP. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgement Fund. However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

The fast-combat support ship USNS Supply (T-AOE 6) transits the Baltic Sea during exercise Baltic Operations (BALTOPS) 2020. (U.S. Navy photo by Mass Communication Specialist 1st Class Kyle Steckler/Released)

NOTE 14. DISCLOSURES RELATED TO THE STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources (SBR) is presented on a combined basis in accordance with OMB Circular A-136; thus, intra-entity transactions have not been eliminated from the amounts presented.

AVAILABLE CONTRACT AUTHORITY

Contract authority represents authority that permits the DON WCF to incur obligations in advance of an appropriation, offsetting collections, or receipts to make outlays to liquidate the obligations. As of September 30, 2020, there is $38.7 billion in total budgetary resources including $11.0 billion in contract authority.

UNDELIVERED ORDERS AT THE END OF THE PERIOD

As outlined in OMB A-136, undelivered orders are separately disclosed as intragovernmental and non-federal amounts. For FY 2020, the DON WCF adopted a methodology to estimate intragovernmental and non-federal undelivered orders based on the total federal and non-federal designation for Accounts Payable, prepaid advances and prepayments.

As of September 30 ($ in thousands)	Unaudited 2020
Intragovernmental:	
Unpaid	$ 13,189,618
Prepaid/Advanced	2,580
Total Intragovernmental	**13,192,198**
Non-Federal:	
Unpaid	4,284,046
Prepaid/Advanced	341,311
Total Non-Federal	**4,625,357**
Total Budgetary Resources Obligated for Undelivered Orders at the End of the Period	**$ 17,817,555**

EXPLANATION OF DIFFERENCES BETWEEN THE COMBINED STATEMENT OF BUDGETARY RESOURCES AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The Statement of Budgetary Resources has been prepared to agree with the amounts shown in the Budget of the United States Government. The Budget of the United States Government containing the actual amounts for FY 2020 has not been published at the time these financial statements were prepared. The FY 2021 Budget of the United States Government with the actual FY 2019 amounts was released in February 2020. The FY 2022 Budget of the United States Government with the actual amounts for the current year (FY 2020) will be available at a later date on OMB website at https://www.whitehouse.gov/omb/budget/.

The table below presents the FY 2019 differences between the amounts reported in the FY 2019 SBR and the actual FY 2019 amounts reported in the FY 2021 Budget of the U.S. Government for SBR lines Total Budgetary Resources; New Obligations and Upward Adjustments; Outlays, Net; and Distributed Offsetting (Receipts)/Outlays, Net.

As of September 30 ($ in billions)	Fiscal Year 2019 Actual			
	Total Budgetary Resources	New Obligations & Upward Adjustments (Total)	Distributed Offsetting Receipts	Net Agency Outlays
FY 2019 Combined Statement of Budgetary Resources	$ 40.3	$ 37.8	$ —	$ 1.0
Budget of the US Government	40.3	37.8	—	1.0
Difference	$ —	$ —	$ —	$ —

NOTE 15. INCIDENTAL CUSTODIAL COLLECTIONS

The DON WCF collected $0.5 million of incidental custodial revenues generated primarily from penalties, fines and administrative fees. These funds are not available for use by the DON WCF. At the end of each fiscal year, the accounts are closed, and the balances rendered to the Treasury.

Marines with the 1st MAW conduct rapid deployment training to increase the confidence of III MEF's ability to rapidly deploy and maintain a secure Indo-Pacific region. (U.S. Marine Corps photo by Sgt. Amaia Unanue/Released)

NOTE 16. RECONCILIATION OF NET COST TO NET OUTLAYS

As of September 30 ($ in thousands)	Unaudited 2020		
	Intragovernmental	With the public	Total
Net Cost of Operations (SNC)	$ (21,189,863)	$ 23,529,910	$ 2,340,047
Components of Net Cost That are Not Part of Net Outlays:			
Property, Plant, and Equipment Depreciation	—	(188,069)	(188,069)
Property, Plant, and Equipment Disposal & Revaluation		(1,853,782)	(1,853,782)
Other	(345,606)	(9,632,060)	(9,977,666)
Increase/(Decrease) in Assets:			
Account Receivable	15,005	(40,525)	(25,520)
Other Assets	(325)	(528,902)	(529,227)
(Increase)/Decrease in Liabilities:			
Accounts Payable	(265,011)	1,952,629	1,687,618
Salaries and Benefits	(18,879)	(230,895)	(249,774)
Environmental and Disposal Liabilities	—	287,321	287,321
Other Liabilities (Unfunded Leave, Unfunded FECA, Actuarial FECA)	44,290	47,340	91,630
Other Financing Sources:			
Federal Employee Retirement Benefit Costs Paid by OPM And Imputed to the Agency	(496,390)	—	(496,390)
Other Imputed Financing	(11,491)	—	(11,491)
Total Components of Net Cost That Are Not Part of Net Outlays	**(1,078,407)**	**(10,186,943)**	**(11,265,350)**
Components of Net Outlays That Are Not Part of Net Cost:			
Acquisition of Capital Assets	—	2,070,450	2,070,450
Acquisition of Inventory	9,836	5,809,146	5,818,982
Other	(6,598)	36	(6,562)
Total Components of Net Outlays That Are Not Part of Net Cost	**3,238**	**7,879,632**	**7,882,870**
Net Outlays	$ (22,265,032)	$ 21,222,599	$ (1,042,433)
Agency Outlays, Net, Statement of Budgetary Resources			$ 758,002
Reconciling Difference			$ (1,800,435)

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position, so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis above illustrates this reconciliation by listing the key differences between net cost and net outlays.

Due to the budgetary and financial accounting information differences mentioned above and financial system limitations, there is a $1.8 billion difference between net cost and net outlays. This difference is primarily attributable to processes relating to purchasing Inventory and OM&S.

NOTE 17: COVID-19 ACTIVITY

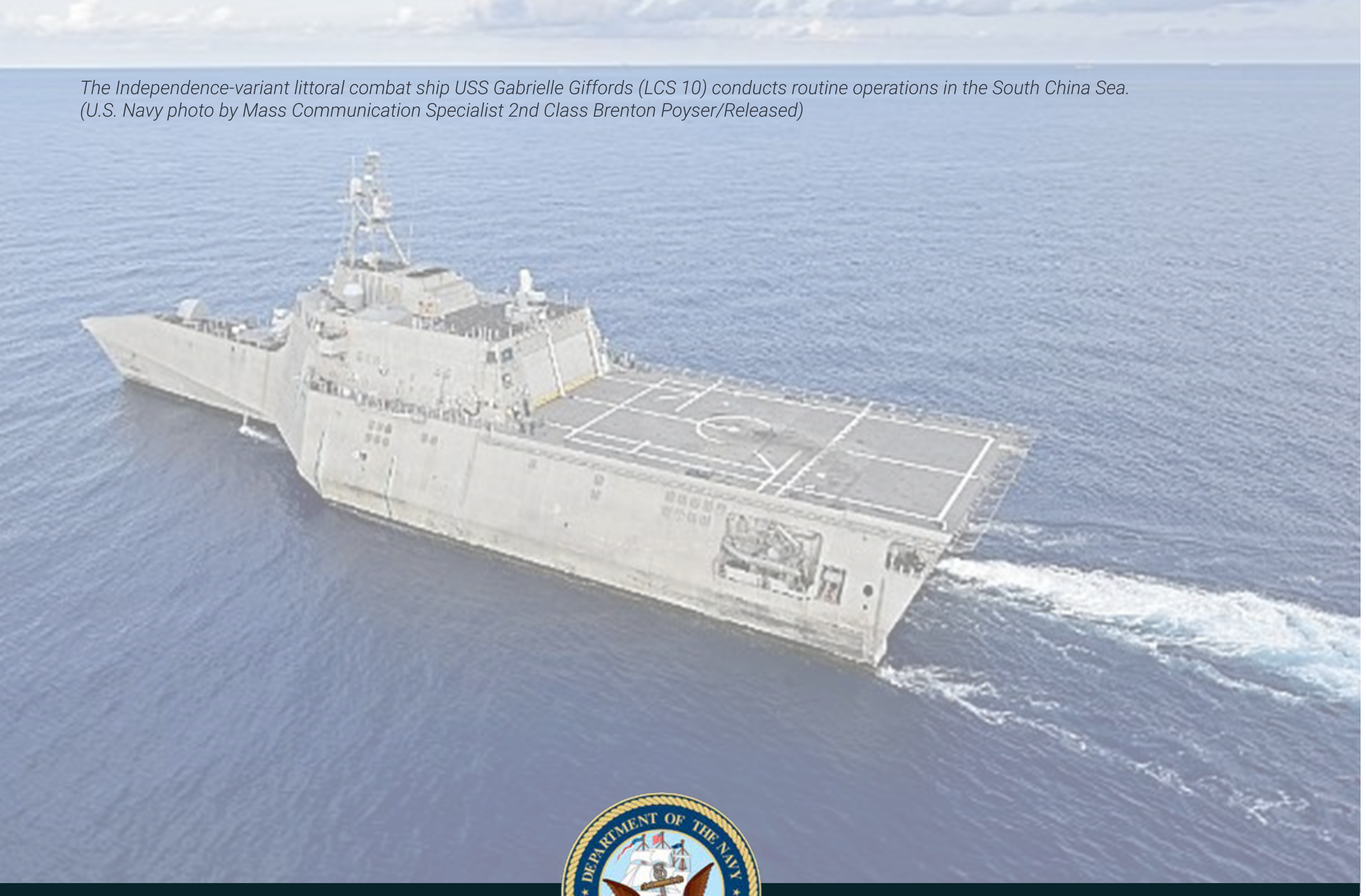
On March 13, 2020 the United Stated declared a national emergency concerning the COVID-19 Outbreak. Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R 748-240/Public Law 116-136) to respond to the COVID-19 outbreak and its impact on the economy, public health, state and local governments, individuals, and businesses. The DON WCF subsequently received $475.0 million in funding (appropriated authority) related to the CARES Act beginning in Q2 FY 2020. As of Q4FY 2020, the entire funding received from the CARES Act is obligated.

The CARES Act supplemental received helped mitigate the DON WCF low cash balances, lost revenue, and unbudgeted costs, such as cleaning, personal protective equipment and administrative leave for high risk personnel for health and safety reasons, related to the coronavirus. The funding received bolstered the DON WCF cash balance, without which, the DON WCF would have experienced an Anti-deficiency Act (ADA) violation.

Due to system limitations, the DON WCF does not currently report proprietary accounting transactions related to COVID-19 activity.

COVID 19 SUMMARY ($ in Millions)

	Unaudited 2020	
TAS - Description	Appropriations Received	Obligated Balance
4930 - Defense Working Capital Fund – Navy	$ 475.0	$ 475.0
Unaudited 2020	—	—
Total	**$ 475.0**	**$ 475.0**



The Independence-variant littoral combat ship USS Gabrielle Giffords (LCS 10) conducts routine operations in the South China Sea. (U.S. Navy photo by Mass Communication Specialist 2nd Class Brenton Poyser/Released)

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND

REQUIRED SUPPLEMENTARY INFORMATION

This section provides the Required Supplementary Information to accompany the basic financial statements as prescribed by accounting standards.

Deferred Maintenance and Repair

The DON WCF real property deferred maintenance and repair information for fiscal year ended September 30, 2020 is reported with the USN GF deferred maintenance and repair. Refer to USN GF Required Supplementary Information.

Disaggregated Statement of Budgetary Resources

The Combined Statement of Budgetary Resources combines the availability, status, and outlays of the DON WCF budgetary resources. The Statement of Disaggregated Budgetary Resources provides the Combined Statement of Budgetary Resources disaggregated by the DON WCF program for the fiscal year ended September 30, 2020.

DEPARTMENT OF THE NAVY WORKING CAPITAL FUND
Statement of Disaggregated Budgetary Resources
For the Fiscal Year Ended September 30, 2020

($ in thousands)	Operations, Readiness & Support	Total
BUDGETARY RESOURCES:		
Unobligated Balance from Prior Year, net (discretionary and mandatory)	$ 3,789,765	$ 3,789,765
Appropriations (discretionary and mandatory)	708,500	708,500
Contract Authority (discretionary and mandatory)	10,994,061	10,994,061
Spending Authority from Offsetting Collections (discretionary and mandatory)	23,216,183	23,216,183
TOTAL BUDGETARY RESOURCES	**$ 38,708,509**	**$ 38,708,509**
STATUS OF BUDGETARY RESOURCES:		
New Obligations and Upward Adjustments (total)	34,633,764	34,633,764
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	3,205,091	3,205,091
Exempt from Apportionment, Unexpired Accounts	1,696	1,696
Unapportioned, unexpired accounts	867,958	867,958
Unexpired Unobligated Balance, End of Year	4,074,745	4,074,745
Unobligated Balance, End of Year (total)	4,074,745	4,074,745
TOTAL BUDGETARY RESOURCES	**$ 38,708,509**	**$ 38,708,509**
OUTLAYS, NET, AND DISBURSEMENTS, NET		
Outlays, Net (total) (discretionary and mandatory)	$ 758,002	$ 758,002
AGENCY OUTLAYS, NET (DISCRETIONARY AND MANDATORY)	**$ 758,002**	**$ 758,002**

The accompanying notes are an integral part of these statements.

THIS PAGE INTENTIONALLY LEFT BLANK

DOD INSPECTOR GENERAL'S TRANSMITTAL LETTER

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

December 15, 2020

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF FINANCIAL OFFICER, DOD
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
NAVAL INSPECTOR GENERAL

SUBJECT: Transmittal of the Independent Auditor's Report on the Department of the Navy Working Capital Fund Financial Statements and Related Notes for FY 2020 (Project No. D2020-D000FS-0060.000, Report No. DODIG-2021-038)

We contracted with the independent public accounting firm of Ernst & Young, LLP, (EY) to audit the Department of the Navy (DON) Working Capital Fund Financial Statements and related notes as of and for the fiscal year ended September 30, 2020. The contract required EY to provide a report on internal control over financial reporting and compliance with laws and other matters, and to report on whether the DON's Working Capital Fund financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). The contract required EY to conduct the audit in accordance with generally accepted government auditing standards (GAGAS); Office of Management and Budget audit guidance; and the Government Accountability Office/Council of the Inspectors General on Integrity and Efficiency "Financial Audit Manual," June 2018, Updated April 2020. EY's Independent Auditor's Report is attached.

EY's audit resulted in a disclaimer of opinion. EY could not obtain sufficient, appropriate audit evidence to support the reported amounts within the DON Working Capital Fund Financial Statements. As a result, EY could not conclude whether the financial statements and related notes were presented fairly in accordance with Generally Accepted Accounting Principles. Accordingly, EY did not express an opinion on the DON Working Capital Fund FY 2020 Financial Statements and related notes.

EY's separate report, "Report of Independent Auditors on Internal Control Over Financial Reporting, Based on an Engagement to Audit the Financial Statements Performed in Accordance with Government Auditing Standards," discusses 11 material weaknesses related to the DON

Working Capital Fund's internal controls over financial reporting.[*] Specifically, EY's report describes the following material weaknesses.

- The DON did not have adequate documentation of financial reporting policies and procedures including internal controls, did not sufficiently oversee and monitor the financial reporting process and service providers, and did not have internal controls over compliance with accounting standards and regulatory guidance.
- The DON did not have adequate documentation of Fund Balance With Treasury accounting policies and procedures. Additionally, the DON did not effectively design or implement internal controls and could not reconcile Fund Balance With Treasury from its general ledger to the U.S. Treasury.
- The DON did not have accounting policies, procedures, and internal controls for inventory. Additionally, the DON was unable to substantiate the existence, completeness, and condition of its inventory and failed to effectively implement controls over inventory transactions.
- The DON did not have adequate documentation of General Equipment – Remainder accounting policies, procedures, and internal controls. Additionally, the Navy lacked internal controls over physical counts, the implementation of accounting standards, and financial reporting.
- The DON did not have adequate policies, procedures, and internal controls over the expense and accounts payable processes, including the accounts payable accrual process.
- The DON did not have adequate documentation of accounting policies, procedures, and internal controls for its reimbursable work order-performer process. Additionally, the DON lacked adequate controls over financial reporting of revenue transactions and its rate setting process.
- The DON did not have adequate documentation of its budget execution policies and procedures and lacked effectively designed internal controls over its budget execution process.
- The DON did not implement sufficient entity-level control, including documentation of policies and procedures that described the DON's environment related to end-to-end business processes, roles, and responsibilities and the monitoring of service providers, risks, and controls.
- The DON information systems environment had weaknesses in access control and segregation of duties, including incomplete and inaccurate user populations, inconsistent user access provisioning and termination processes, and inconsistent periodic reviews of user access.

[*] A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that results in a reasonable possibility that management will not prevent, or detect and correct, a material misstatement in the financial statements in a timely manner.

- The DON information systems environment had weaknesses in configuration management including the logging and monitoring of configuration changes, an incomplete or inaccurate population of system changes, and ineffective segregation of duties within the change management process.
- The DON information systems environment had weaknesses in its interface processing control (such as a lack of a complete population of interfaces, edit validation checks, and reconciliations and the inability to determine data transfer completeness, timeliness, and accuracy) that represent significant risk to the DON's financial information.

EY's additional report, "Report of Independent Auditors on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards," discusses two instances of noncompliance with applicable laws and regulations. Specifically, EY's report describes instances in which the DON's financial management systems did not comply with FFMIA and the Federal Managers' Financial Integrity Act of 1982.

In connection with the contract, we reviewed EY's reports and related documentation and discussed them with EY representatives. Our review, as differentiated from an audit of the financial statements in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on the DON Working Capital Fund FY 2020 Financial Statements and related notes. Furthermore, we do not express conclusions on the effectiveness of internal control over financial reporting, on whether the DON Working Capital Fund's financial systems substantially complied with FFMIA requirements, or on compliance with laws and other matters. Our review disclosed no instances where EY did not comply, in all material respects, with GAGAS. EY is responsible for the attached December 15, 2020 reports, and the conclusions expressed within the reports.

We appreciate the cooperation and assistance received during the audit. Please direct questions to me.

Lorin T. Venable

Lorin T. Venable, CPA
Assistant Inspector General for Audit
Financial Management and Reporting

Attachments:
As stated

INDEPENDENT AUDITORS' REPORT

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Working Capital Fund of the United States Department of the Navy (DON), which comprise the consolidated Balance Sheet as of September 30, 2020, and the related consolidated Statements of Net Costs, Changes in Net Position, and the combined Statement of Budgetary Resources for the year then ended, and the related notes to the financial statements (financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Departure from U.S. Generally Accepted Accounting Principles

As described in Note 1, the DON has not implemented certain accounting standards related to accounting issues for the Department of Defense and the Federal government. The effect on the financial statement amounts involved is not currently determinable by the DON and could be material.

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Basis for Disclaimer of Opinion

The DON continues to have unresolved accounting issues and material weaknesses in internal controls that cause the DON to be unable to provide sufficient evidential support for complete and accurate financial statements on a timely basis. As a result, we cannot determine the effect of the lack of sufficient appropriate audit evidence on the DON's financial statements as of and for the year ended September 30, 2020.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that Management's Discussion and Analysis and Required Supplementary Information, as listed in the Table of Contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph. We do not express an opinion or provide any assurance on the information.

Other Information

We were engaged for the purpose of forming an opinion on the financial statements that collectively comprise the DON's basic financial statements. The Other Information, as listed in the Table of Contents, is presented for the purposes of additional analysis and is not a required part of the financial statements. The Other Information has not been subjected to the auditing procedures applied in the engagement to perform an audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

EY Building a better working world
Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102
Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we also have issued our reports dated December 15, 2020 on our consideration of the DON's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of those reports is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the DON's internal control over financial reporting or on compliance. Those reports are an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the DON's internal control over financial reporting and compliance.

Ernst & Young LLP

December 15, 2020

EY Building a better working world
Ernst & Young LLP
1775 Tysons Blvd
Tysons, VA 22102
Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors on Internal Control Over Financial Reporting Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund (WCF) of the United States Department of the Navy (DON), which comprise the consolidated Balance Sheet as of September 30, 2020, the related consolidated Statements of Net Cost and Changes in Net Position, the combined Statement of Budgetary Resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 15, 2020. Our report disclaims an opinion on such financial statements because the DON was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered the DON's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DON's internal control. Accordingly, we do not express an opinion on the effectiveness of the DON's internal control. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to preparing performance information and ensuring efficient operations.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. As described below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described below and in Appendix A as items I through XI to be material weaknesses.

Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the DON's ability to produce reliable financial statements, accompanying notes, and related disclosures. The DON's management has not adequately designed financial reporting controls and inappropriately relies on the DON's financial reporting service provider to execute its responsibilities for the design, performance, and oversight of internal controls over financial reporting. The combination of these deficiencies results in a material weakness. The matters related to Financial Reporting are further described in Appendix A.

II. Fund Balance with Treasury

Fund Balance with Treasury (FBwT) represents the aggregate amount of funds in the DON's accounts with the U.S. Treasury. Lack of adequate controls over the FBwT process, including reconciliations with Treasury, prevents the DON from substantiating the reported balance on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to FBwT are further described in Appendix A.

III. Inventory

Inventory is comprised of consumable spare parts, repair parts, and repairable items. Inadequate internal controls over the DON Inventory process, including oversight of third parties, prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Inventory are further described in Appendix A.

IV. Property, Plant, & Equipment: General Equipment Remainder

PP&E General Equipment Remainder (GE-R) is primarily comprised of equipment used in research, development, and maintenance. The DON has failed to implement effective policies and procedures over GE-R and lacks adequate controls over the life cycle of recording GE-R (i.e., receipt, acceptance, maintenance, issuance, and disposal) within an approved system. This prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to GE-R are further described in Appendix A.

V. Expenses and Accounts Payable

Expenses are incurred and recognized when the DON obtains goods and services from the public or other Federal entities. Accounts Payable (AP) represents the amount owed to third parties by the DON for goods and services received. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the DON from substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Expenses and AP are further described in Appendix A.

FINANCIAL SECTION US NAVY WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

VI. Revenue, Accounts Receivable, and Unfilled Customer Orders

Revenue, Accounts Receivable (AR), and Unfilled Customer Orders includes amounts earned by the DON from the sale of goods and services provided to the Navy General Fund (GF), other Department of Defense (DoD) and federal agencies, and the public. The DON determines revenue through their stabilized billing rates, established by the individual Budget Submitting Offices (BSOs) and charged to their customers. The bill rates should recoup all amounts necessary to recover the full costs of providing the goods and services. Lack of adequate policies, procedures, internal controls and supporting documentation prevents the DON from determining if bill rates are adequate and substantiating the reported balances on the financial statements and notes. The combination of these deficiencies results in a material weakness. The matters related to Revenue, AR, and Unfilled Customer Orders are further described in Appendix A.

VII. Budget Execution and Undelivered Orders

Budget Execution represents the use of funds from the time the funds are received through the outlay and reporting of those funds. Undelivered Orders (UDOs) represent the amount of goods or services ordered which have not been received. Lack of adequate policies, procedures, internal controls and related supporting documentation over the Budget Execution process, including the recognition and reporting of UDOs, prevent the DON from substantiating the reported balances on the Statement of Budgetary Resources and related notes. The combination of these deficiencies results in a material weakness. The matters related to Budget Execution and UDOs are further described in Appendix A.

VIII. Entity Level Controls – Oversight and Monitoring

FMFIA requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The DON has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA, leading to inadequate control environment and monitoring processes and insufficient risk assessment. The combination of these deficiencies results in a material weakness. The matters related to Entity Level Controls - Oversight and Monitoring are further described in Appendix A.

IX. Financial Information Systems – Access Controls/Segregation of Duties

Access Controls include those controls related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. We identified access control and segregation of duties (SoD) deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Access Controls and SoD are further described in Appendix A.

X. Financial Information Systems – Configuration Management

Configuration Management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematic control changes to that configuration during the system's life cycle. We identified configuration management deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Configuration Management are further described in Appendix A.

XI. Financial Information Systems – Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. We identified interface processing deficiencies that represent a significant risk to the financial management information systems environment. The combination of these deficiencies results in a material weakness. The matters related to Interface Processing are further described in Appendix A.

Management's Response to Findings

The DON's response to the findings identified in our engagement to audit and relevant comments from the DON's management are provided in their accompanying letter dated December 15, 2020. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

December 15, 2020

Appendix A – Material Weaknesses

I. Financial Reporting

Financial Reporting encompasses all aspects of operations affecting the DON's ability to produce reliable financial statements, accompanying notes, and related disclosures. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls to achieve reliable financial reporting. According to the Government Accountability Office (GAO) Standards for Internal Control in the Federal Government (commonly referred to as the Green Book) issued under the authority of FMFIA, management is responsible for implementing and evaluating its internal control system, including internal controls to meet reporting objectives related to the preparation of reports for use by the entity, its stakeholders, or other external parties. In addition, according to the GAO Green Book, management may engage third parties to perform certain operational processes for the entity; however, management retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by third parties. Despite these requirements, management has not adequately designed financial reporting controls and inappropriately relies on its service provider to execute the DON's responsibilities for the design, performance, and oversight of internal controls over financial reporting. These control weaknesses, as detailed below, can lead to misstatements on the DON's financial statements:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the financial reporting process are not accurately or completely documented.
2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.** As noted below, the DON lacks adequate oversight over financial reporting processes executed across the organization:

   Budget Submitting Offices Financial Reporting Process

   - The DON does not have adequately documented policies and procedures, including internal controls, to properly reconcile their general ledgers to trial balances (TB) submitted to the DON's financial reporting service provider, the Defense Finance and Accounting Service (DFAS), including defining the role of Assistant Secretary of the Navy (ASN) Financial Management and Comptroller (FM&C) and the BSOs in that process. In addition, Navy Enterprise Resource Planning (ERP) does not have system controls in place to prevent Journal Vouchers (JVs) that have not been reviewed and approved from being posted directly into Navy ERP. The DON does not have appropriate controls to track the JVs recorded each month to ensure they are properly reviewed and monitored or approved by ASN FM&C. This has led to recording JVs that are incomplete, inaccurate, or non-compliant with Treasury Financial Manual (TFM) requirements.

   Office of Financial Management Operations (FMO) Financial Reporting Process

   - ***Financial Reporting Process.*** FMO lacks appropriate oversight and controls related to JV preparation and review, financial reporting compilation and presentation, and the close process. Currently, the controls in place are not designed effectively, missing comprehensive reviews over the financial statements, accompanying footnotes, and related disclosures. In addition, the DON lacks appropriate controls over the preparation and review of recurring and non-recurring JVs, including related reconciliations.

- FMO lacks adequate oversight and monitoring over WCF Real Property financial reporting. This resulted in assets that should have been transferred out of the DON WCF to be financially reported in FY20 Q4.
- ***System Conversions.*** FMO lacks adequate oversight and monitoring as well as sufficient policies and procedures over system conversions to ensure timely, accurate and complete financial reporting.

3. **Lack of Oversight of Financial Reporting Service Provider.** The DON lacks appropriate oversight of DFAS related to the execution of financial reporting controls and does not have adequate monitoring controls in place to evaluate actions taken by DFAS. Specifically, we noted the following control weaknesses:

Journal Vouchers

- FMO does not have adequately designed monitoring controls over manual and system generated JVs initiated and recorded by DFAS. Specifically, the review process is not comprehensive and fails to include attributes such as completeness of the JV, compliance with the TFM, and the review of the support prior to recordation by DFAS.

Trading Partner Eliminations

- On behalf of the DON, DFAS records trading partner eliminations that are not supported by transaction details, and therefore are not compliant with accounting standards. The DON's unsupported trading partner eliminations impact all of the DON's financial statements. The total amount of trading partner eliminations recorded at Q4 was $10 billion.

Data Processing

- Monitoring controls over data processing actions taken by DFAS impacting the financial statements are inadequate. Management relies on DFAS to process financial information through the Defense Departmental Reporting System-Budgetary (DDRS-B) and the Defense Departmental Reporting System-Audited Financial Statements (DDRS-AFS), but has not designed sufficient policies and procedures to reconcile its general ledger information against DDRS-B and DDRS-AFS to include verification of the completeness, accuracy, and validity of the TBs.

Complementary User Entity Controls (CUECs)

- CUECs are controls that users of the service organization (DON) should have in place to supplement the service organization's (DFAS) internal controls. Management has not appropriately designed or implemented CUECs, and therefore, is unable to ensure that controls executed by the service organizations achieve their intended outcome.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.** The DON lacks adequate financial reporting controls to ensure compliance with applicable accounting standards and regulatory reporting requirements as follows:

Federal Accounting Standards Advisory Board (FASAB) Standards

- As noted in Note 1B, *Basis for Accounting and Presentation*, the DON is not in compliance with accounting standards established by FASAB. In addition, management lacks policies and procedures over reporting for leases in accordance with accounting standards.

Office of Management and Budget (OMB) Circular A-136

- The Agency Financial Report is not in compliance with financial reporting requirements for form and content which includes its financial statements and disclosures as established within OMB Circular A-136, *Financial Reporting Requirements*. For example, activities are not classified appropriately within Note 16, *Reconciliation of Net Cost to Net Outlays*, which reconciles budgetary to proprietary transactions are not classified appropriately. Also, as presented, the note includes a $1.8 billion unsupported budgetary to proprietary difference.

Treasury United States Standard General Ledger (USSGL)

- The DON is not in compliance with Treasury's USSGL at the transaction level as required by the Federal Financial Management Improvement Act of 1996. Examples of significant processes that are not recorded in compliance with the USSGL include: Budget Execution and Undelivered Orders, Revenue, Accounts Receivable, Unfilled Customer Orders, and Inventory.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of Financial Reporting Policies and Procedures, including Controls.**
   - Complete a Process Cycle Memorandum (PCM) that documents the end-to-end process for the entire life cycle of Financial Reporting, specific to the DON, including the initiation, recording, processing, and reporting of financial statement data.
   - The PCM should include all key controls, assertions, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all applicable systems and system generated reports used for the Financial Reporting process.
   - All process owners should review and sign off on the updated PCM to validate that the PCM is complete and accurate.

2. **Lack of Sufficient Oversight and Monitoring of Financial Reporting Process.**

Budget Submitting Offices Financial Reporting Process

- Design and implement policies and procedures governing the assessment and documentation of variances identified during the monthly TB reconciliation process which includes, but is not limited to, whom is responsible for the reconciliation, variance investigation threshold, and protocols for timely investigation of variances.
- Design and implement policies and procedures for retention of documentation related to TB reviews and reconciliations.
- Develop a system control to prevent unapproved JVs from being posted.
- Document policies and procedures arising from the development of a new system control, including the monitoring of users with access to oversee the control.
- Perform an analysis over any remaining BSO JVs to identify and correct instances where JVs do not comply with TFM posting logic.
- Design and implement sufficient policies and procedures to ensure any remaining field level JV logs are complete and accurate and reviewed in a timely manner.

Office of Financial Operations Financial Reporting Process

- Develop and implement a methodology that allows for complete and accurate disclosure of financial statement footnotes including the values presented in the footnotes, relationships between presented accounts, and all variances and reconciling items.
- Design controls that timely reconcile detailed transactions to TBs submitted to DDRS.
- Design sufficient controls to ensure the completeness and accuracy of the data used in TB reconciliations.
- Implement and document controls to verify the completeness and accuracy of reports received from DFAS prior to using them to perform analysis and as JV support.
- Periodically (at least annually) evaluate and update Standard Operating Procedures to ensure that the procedures described are the procedures performed.
- Periodically (quarterly) update Delegations of Authority to reflect personnel changes.

System Conversions

- Design and implement oversight and monitoring controls that address all financial reporting risks when implementing system conversions.
- Ensure that policies and procedures governing all commands' conversions are finalized and approved before conversion procedures begin.
- Develop policies and procedures to minimize i) the duration that a command cannot enter transactions in the target system ("black-out" period) and ii) the duration that a command cannot financially report out of either the legacy or target system ("brown-out" period).
- Establish policies, procedures, and controls to ensure that all accounting functions can be performed and recorded in a timely, complete, and accurate manner during system black-outs and brown-outs.

3. **Lack of Oversight of Financial Reporting Service Provider.**

Journal Vouchers

- Develop policies and procedures for performing a qualitative review and approval of JVs within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and the potential impact on the financial statements.
- Develop more comprehensive policies and procedures for quantitative review and approval requirements within the accounting environment to accurately identify and address additional risks for JVs recorded by DFAS and potential impact on the financial statements.
- Do not permit DFAS to support JVs with only detail obtained from DDRS-B and DDRS-AFS. Transactional level support should be provided by the DON.
- Record JVs to the appropriate USSGL accounts that are consistent with the business rationale for the transaction.
- Develop and implement control procedures to review DDRS-B system generated JVs at a more precise level of aggregation so that the procedures performed provide comfort over system generated entries.

Trading Partner Eliminations

- In conjunction with DFAS coordinate with the Office of the Secretary of Defense (OSD) to address the trading partner eliminations issue at the department level and develop next steps towards remediation, such as updating the DoD Financial Management Regulation (FMR).
- Implement document level reconciliations with the DON trading partners and develop a process for resolving differences at the document level.

Data Processing

- Document policies and procedures governing the performance, documentation, and assessment of management review controls performed by DFAS on the DON's behalf.
- Enhance management review and analysis procedures to ensure completeness, validity, and accuracy of the information reported to DFAS and subsequently processed by DFAS through the transaction universe reconciliation.
- DON should enhance and implement sufficient management review controls to determine the reasonableness of the explanations provided by the system owners.

Complementary User Entity Controls

- Evaluate the current System and Organization Control (SOC) 1 reports to determine if they are appropriate to cover the end-to-end business processes.

- Design and implement internal controls that address the CUECs identified in the DFAS SOC 1 reports.

4. **Lack of Controls over Compliance with Accounting Standards and Regulatory Guidance.**
   - Develop and implement policies and procedures that ensure compliance with the applicable accounting authoritative standards.

II. Fund Balance with Treasury

FBwT represents the aggregate amount of funds in the DON's accounts with the U.S. Treasury. Reconciliation of agencies' FBwT general ledger accounts to the balances held at Treasury is a key internal control process which ensures the accuracy of the agencies', as well as the government-wide, receipt and disbursement data. TFM Chapter 5100, Section 5120 requires agencies to implement an effective and efficient reconciliation process and perform timely reconciliations. Lack of adequate controls over the FBwT process, including reconciliations, can lead to misstatements to the financial statements as well as reports used by management to control the use of its funds. Inadequate procedures, including oversight, over the FBwT process has led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of FBwT Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the FBwT process are not accurately or completely documented. This includes roles, responsibilities, processes, and transactions executed at each of its disbursing stations and the process of reconciling to the U.S. Treasury.
2. **Lack of Effectively Designed or Implemented Controls in the FBwT process.** Controls are not designed adequately to ensure deposit-in-transit, suspense, unmatched and interfund transactions are recorded timely and appropriately.
3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.** The FBwT reconciliation is not adequately designed. The reconciliation does not produce a complete population of transactions impacting collections and disbursements. In addition, the DON doesn't perform sufficient research and resolution of variances identified during the reconciliation prior to the recording of JVs to agree the DON's books to Treasury's reported balance.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of FBwT Accounting Policies and Procedures, including Controls.**
   - Finalize a PCM that documents the end-to-end process for the entire life cycle of FBwT, including initiating, recording, processing, reporting of cash transactions, and reconciliations.

FINANCIAL SECTION US NAVY WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

   - The PCM should include all key controls, assertions, process owners, data interfaces, and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system generated reports used for the FBwT process.
   - Require all process owners to review and sign off on the updated PCM to validate that the PCM is complete and accurate.
2. **Lack of Effectively Designed or Implemented Controls in the FBwT Process**.
   - Implement control procedures to require timely research and resolution of variances within 60 business days of transaction date.
   - Implement control procedures to monitor compliance and accountability of those responsible for resolving variances.
3. **Inability to Reconcile FBwT from the General Ledger to the U.S. Treasury.**
   - Ensure disbursements and collections are accurately recorded in the general ledger system and financially reported from the general ledger system.
   - Implement a single reconciliation tool that supports the DON's initiative to utilize Treasury Direct Disbursing from the general ledger systems.
   - Identify the necessary data attributes to identify transactions recorded in suspense specific to the DON and develop an estimate using relevant, sufficient, and reliable information to record the DON's suspense account balances on the DON's financial statements.

III. Inventory

WCF Supply Management – Inventory is comprised of consumable spare parts, repair parts, and repairable items. As of September 30, 2020, inventory is located across over 1,300 sites within and outside of the United States and is comprised of approximately 500,000 unique items – identified through National Item Identification Numbers (NIINs). The Naval Supply Systems Command (NAVSUP) provides program and inventory management for inventory and is the only entity that has financial reporting responsibility for inventory. Inventory is held at DON-managed ashore and afloat sites, Marine Corps Logistic Command (LOGCOM) sites, and third-party managed sites operated by other defense agencies such as the Defense Logistics Agency (DLA), Army, Air Force, and commercial contractors. The DON reports the status of inventory using Navy ERP, which is the system of record for NAVSUP inventory. LOGCOM reports the status of the DON inventory held in its warehouses using the Stock Control System. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability for all assets for which the agency is responsible.

Due to the significance of inventory, both operationally and financially, a robust control environment is essential. Lack of adequate controls over the inventory process can lead to misstatements in the financial statements and an inability to produce accurate information and data to effectively manage the inventory process. Inadequate controls, including oversight, over the DON inventory process have led to the following internal control deficiencies:

EY Building a better working world

1. **Lack of Inventory Accounting Policies and Procedures, including Controls.** The DON failed to effectively design and document policies, procedures, and controls over inventory transactions.

   Process Cycle Memorandum

   - The end-to-end processes, procedures, and key controls for significant portions of the inventory process are not completely documented. Specifically, the DON failed to document the processes related to inventory managed by LOGCOM, the reclamation of assets from stricken aircraft, processes and procedures related to inventory Held in Reserve for Future Sale, and the condition and associated valuation of inventory Due-In From Maintenance (DIFM).

   NAVSUP Oversight

   - NAVSUP failed to design remediation procedures to research and resolve inventory discrepancies. EY count procedures at one plant resulted in 50% of NIINs tested with exception. Additionally, NAVSUP FY20 oversight testing identified errors that had not been corrected or adjusted in the system as of year-end.
   - NAVSUP failed to design policies and procedures, including oversight controls, related to the accountability of the DON's inventory at both organic and contractor sites. For example, five BSOs (Naval Air Systems Command, Naval Sea Systems Command, NAVSUP, Naval Information Warfare Systems Command, and Strategic Systems Program) asserted that a 100% completed wall-to-wall had been performed as of FY20 Q2; however, not all sites had performed the control.

   Inventory Held by Third Parties

   - The DoD FMR Volume 4, Chapter 4, section 040406 requires that all inventory is counted at least annually, either in a full physical count or through cycle counts to validate perpetual inventory accuracy. The DON failed to develop annual physical count procedures for inventory held by third parties.

   Financial Reporting of Inventory and Accounting Standards

   - The DON failed to design policies, procedures, and controls to ensure that inventory balances are appropriately reconciled between the systems and the TB for both NAVSUP and LOGCOM managed inventory. This results in an unsupported JV to agree system balances to the financial statement balance as of September 30, 2020.
   - The DON failed to design policies, procedures, and controls to effectively implement accounting standards, causing inaccurate presentation of inventory on the balance sheet and in the related footnote disclosure. Specifically:
     - Inventory has not been valued in accordance with FASAB Statement of Federal Financial Accounting Standards (SFFAS) 3 or SFFAS 48.
     - Inventory allowances are not accurate or supported.

FINANCIAL SECTION US NAVY WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

EY Building a better working world

     - Excess, obsolete, and unserviceable (EOU) inventory valuation is inaccurate and unsupported.
     - Supply condition codes have not been accurately reported in accordance with the USSGL.

2. **Inadequate Inventory Policies and Procedures, including Controls.** Given the control weaknesses noted below, the DON is unable to substantiate the existence, completeness, and condition of its inventory.

   Afloat Inventory Physical Counts

   - NAVSUP failed to design adequate policies and procedures, including internal controls, to properly document, approve, and record gain/loss transactions resulting from physical inventory counts.
   - NAVSUP failed to design adequate policies and procedures, including internal controls, to properly document and approve quarterly inventory counts.

   Virtual Plants

   - NAVSUP failed to design adequate policies and procedures to ensure inventory transactions reported in virtual plants are appropriate. Virtual plants were created to enable reporting at locations that do not maintain transactions in a feeder system. These transactions should be temporary and should always net to zero. However, due to inadequate processing and oversight, virtual plants erroneously reflect inventory balances at year-end and NAVSUP failed to research and resolve the discrepancies in a timely manner.

   Deployed or Sub-custody Assets

   - NAVSUP failed to design adequate policies and procedures to ensure that inventory movements for assets in deployed pack-up kits (PUKs) and in sub-custody are recorded in an accurate and timely manner. For example, 67 NIINs in deployed PUKs (approximately 5% of sampled NIINs) and 33 NIINs in sub-custody (approximately 3% of sampled NIINs) tested with exception because the related inventory balances were not updated timely in ERP or were not supported.

3. **Lack of Implementation of Inventory Policies and Procedures, including Controls.** The DON failed to effectively implement controls over inventory transactions. As a result, the DON's inventory records are not complete, accurate, or reliable.

   Receipt and Issuance

   - NAVSUP failed to implement controls over inventory receipts and issuances to ensure that transactions are recorded in an accurate and timely manner in the inventory feeder systems and Navy ERP. During count procedures, we identified existence and completeness exceptions in 137 NIINs (approximately 11% of sampled NIINs). During roll-forward procedures, we identified exceptions related to untimely recording of transactions related to receipts and issuances of inventory in 135 NIINs (approximately 11% of sampled NIINs).

Asset Condition

- NAVSUP failed to implement controls consistently to ensure that asset condition codes assigned to inventory items in the warehouses agree to the condition codes recorded in Navy ERP. Incorrect condition codes not only result in the misstatement of the item values on the financial statements, but also prevent the DON from knowing the correct quantity of ready for issue items available to support operations. During count procedures, we identified condition code exceptions in 148 NIINs (approximately 12% of sampled NIINs).

Stock in Transit (SIT)

- NAVSUP failed to implement policies and procedures to substantiate inventory items that were recorded as SIT. Specifically, during our testing we noted in-transit items that were recorded in the receiving plant's on hand quantity, but not removed from the plant's open SIT, resulting in the duplicate recording of assets.
- NAVSUP failed to monitor SIT to ensure it is cleared in a timely manner. For example, one plant marked for deactivation had multiple items remaining in SIT.

Inventory Held by DLA

- NAVSUP failed to implement a reconciliation of DLA's Distribution Standard System (DSS) and Navy ERP, including root cause analyses of differences identified through the interface, to ascertain the completeness and accuracy of the inventory transactions in Navy ERP. This results in an unsupported JV recorded by NAVSUP in Navy ERP to match DSS.

Recommendations

Consider the following corrective actions related to the conditions identified above:

1. **Lack of Inventory Accounting Policies and Procedures, including Controls.**

Process Cycle Memorandum

- Document the end-to-end process for the entire life cycle of the Inventory process, including: receiving, distributing, recording, processing and reporting of inventory at all warehouses, including LOGCOM; policies and procedures over the process of reclamation of assets from stricken aircraft; policies and procedures to ensure appropriate reporting of inventory Held in Reserve for Future Sale; and processes and key controls related to the accurate condition and associated valuation of DIFM inventory.

NAVSUP Oversight

- Develop policies and procedures to include timelines for resolution of physical inventory count discrepancies.
- Develop detailed monitoring procedures to ensure that discrepancies and known errors identified during oversight testing are timely corrected.

- Design and implement a management review program in which the DON can monitor the operational activities of the various warehouses to ensure they are in compliance with the DON's inventory policies and procedures such as the NAVSUP Publication 723 on the Navy Inventory Integrity Procedures.
- Design and consistently implement inventory count policies and procedures that ensure inventory at organic sites and DON inventory held by commercial contractors is counted at least once annually.

Inventory Held by Third Parties

- Design and implement a management review program in which NAVSUP monitors the operational activities of the various contractor managed warehouses to ensure the following:
  - Develop inventory count processes for contractor managed warehouses that include a requirement in the agreements between NAVSUP and contractors whereby quantities in the inventory system are supported via physical counts at least once a year either through a wall-to-wall year-end count or adequately designed cycle counts.

Financial Reporting of Inventory and Accounting Standards

- Design policies and procedures to validate the completeness and accuracy of inventory transactions recorded by NAVSUP and LOGCOM to include the following:
  - Implement policies, procedures, and controls to research and resolve identified variances in a timely manner. This should include establishment of a threshold over which the balances will be investigated and corrected for both BSOs and should be performed prior to LOGCOM Navy ERP implementation.
  - Implement management review controls to ensure adjusting JVs are properly supported and executed, for the accurate amount(s), and in accordance with generally accepted accounting principles (GAAP).
- Prior to implementing and applying the valuation methodologies set forth by SFFAS 3 and SFFAS 48, the DON should:
  - Decide what alternative valuation method to use for establishing opening balances. Valuation methodologies used should be based on the best available information to arrive at an alternate value.
  - Outline documentation detailing the implementation plan for SFFAS 48, which provides a description of the process, as well as the proposed application of SFFAS 48.
  - Establish and implement policies and procedures to value inventory that comply with SFFAS 3 on a go forward basis.
  - Ensure management reviews the implementation methodology to ensure correct application of GAAP.
  - Ensure the DON maintains evidential matter (e.g., policies and procedures) which documents steps taken to ensure consistent application of the selected methodology.

Building a better working world

- Develop and implement comprehensive policies and procedures for appropriate use of the Inventory – Allowance account to include the following:
  - Discontinue use of the Allowance account to correct unresolved unreconciled balances.
  - Develop and implement procedures that require periodic performance of causative research to ensure timely resolution of unresolved unreconciled balances.
  - Develop and implement management review controls to ensure that the Inventory - Allowance balance is complete and accurate.
- Develop and implement comprehensive policies and procedures to support the valuation and footnote presentation of EOU inventory:
  - Design and implement controls, policies and procedures to ensure the accurate recording of condition codes for EOU inventory.
  - Design and implement controls, policies and procedures to ensure EOU inventory is valued in accordance with accounting policy.
  - Design and implement management review controls to ensure compliance with accounting policies, procedures, and internal controls.
- Update current policies and procedures to support the alignment of supply condition codes to the USSGL accounts:
  - Develop and implement monitoring procedures for all condition codes to ensure accurate financial reporting at year-end.
  - Develop and document recurring analyses to support management's decisions regarding materiality thresholds.
  - Work with OSD to ensure that policies align with authoritative guidance.

2. **Inadequate Inventory Accounting Policies and Procedures, including Controls.**

   Afloat Inventory Physical Counts

   - Design consistent policies and procedures to include required documentation and levels of approval for quarterly inventory counts and gain by inventory and loss by inventory transactions.
   - Develop and implement oversight procedures to ensure that controls are effectively implemented as designed across the DON.
   - Evaluate whether similar actions are needed for ashore and contractor-held inventory.

   Virtual Plants

   - Design and implement policies, procedures and controls to ensure that the inventory transactions recorded in virtual plants are researched and cleared timely and recorded appropriately.

Building a better working world

   Deployed or Sub-custody Assets

   - Develop and implement policies and procedures to timely capture movement of inventory not physically in custody of the reporting plant.
   - Develop and implement documentation requirements to ensure that deployed or sub-custody assets are supported.
   - Consider implementing additional plant codes so that the reporting of assets is performed by the physical custodian.

3. **Lack of Implementation of Inventory Accounting Policies and Procedures, including Controls.**

   Receipt and Issuance

   - Develop and implement comprehensive policies and procedures to substantiate existence and completeness to include the following:
     - Implement policies, procedures, and controls to record inventory transactions and events in both the inventory feeder systems and Navy ERP in a timely manner.
     - Design policies, processes and controls to appropriately account for carcass items.
     - Design and implement monitoring and oversight procedures to ensure that plants adhere to the controls documented in the P-723 and Internal Control Aids.

   Asset Condition

   - Design and implement internal control procedures to ensure that the accurate condition codes are assigned to the appropriate classes of inventory recorded in the ERP general ledger system and recorded on the inventory labels at the warehouse.

   Stock in Transit

   - Develop and implement comprehensive policies and procedures to substantiate existence of SIT to include the following:
     - Design and implement policies, procedures, and controls to ensure receipt of assets is properly recorded so that SIT items are removed from SIT when received.
     - Design and implement policies, procedures, and controls to ensure that documentation supporting the existence of open in transit items is properly created, utilized, and retained.
     - Design and implement policies, procedures, and controls to research and resolve open SIT records in a timely manner.
     - Design and implement a management review control to validate the SIT receipt and monitoring functions are properly implemented and operating effectively.
     - Perform an analysis at year end to identify known SIT exceptions and quantify the impact to the inventory balance to determine if an adjustment should be recorded.

EY Building a better working world

Inventory Held by DLA

- Design policies and procedures to validate the completeness and accuracy of inventory transactions recorded by DLA to include the following:
  - Implement a reconciliation process between Navy ERP and DLA's DSS to include analysis of differences identified during the process.
  - Configure the system interface between feeder systems including DLA's DSS and Navy ERP to correctly post all movement types within the period to the appropriate general ledger accounts, including the following:
  - Develop an unreconciled balance report that reflects the entire population of unreconciled balances.
  - Design and implement policies, procedures, and controls to research and resolve the unreconciled balances in a timely manner. This should include procedures to determine which balances will be investigated and corrected.
  - Implement management review controls to monitor and approve the status of the unreconciled balances on a periodic basis as well as the maintenance of evidential matter to support the management review process of the unreconciled balances.

IV. Property, Plant, & Equipment – General Equipment - Remainder

GE-R is primarily comprised of equipment used in research, development, and maintenance. In accordance with FMFIA, management is responsible for establishing effective controls over and accountability of property and other assets. The DON lacks adequate controls over the life cycle of recording GE-R assets (i.e., receipt, acceptance, maintenance, issuance, and disposal) leading to inaccuracies within its systems and financial statements. Specifically, inadequate procedures, including oversight over the GE-R process, have led to the following internal control deficiencies:

1. **Lack of or Inadequate Documentation of GE-R Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the GE-R process are not accurately or completely documented. This includes the flow of data through applicable information systems from the initiation of a transaction to reporting in the financial statements, the key stakeholders within the process, and the flow of data between stakeholders.
2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.** The DoD FMR, Volume 4, Chapter 25, Section 250303, requires independent verification of the accuracy of equipment financial transactions through periodic physical counts of general equipment. The counts must also include reconciling the property systems and other systems with the general ledger accounts. Physical count procedures are not designed or operating effectively. Specifically, the DON has not corrected previously identified conditions such as errors in the system's asset listing related to inadequate asset location codes, lack of asset disposal recognition, and lack of recording of existing equipment. Discrepancies identified during physical counts are not resolved within timelines established in the DON's policy (30 days) and that policy is not in accordance with DoD instructions for resolution of discrepancies which requires resolution within 7 days. As a result, the capital equipment balance is misstated in the financial statements and notes.
3. **Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards.** There is a lack of policies and procedures, including internal controls in place to implement accounting standards, causing inaccurate presentation of GE-R on the balance sheet and in the related footnote disclosure. Specifically, implementation of the provisions of SFFAS 50 to establish opening balances and SFFAS 6 to value assets on a go forward basis have not been completed or fully developed.
4. **Inadequate Controls over Financial Reporting of GE-R.** Controls have not been implemented to report GE-R transactions in a timely manner. A population of GE-R, that reconciles to the financial records, is unavailable and variances are not investigated and resolved prior to preparing the financial statements and notes.

Recommendations

Consider the following corrective actions related to the deficiencies identified above:

1. **Lack of or Inadequate Documentation of GE-R Accounting Policies and Procedures, including Controls.**
   - Complete the documentation of the end-to-end process for the entire life cycle of GE-R, including initiating, recording, processing and reporting of GE-R transactions, applicable risks, and key controls that address those risks.
   - Process documentation should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems, and system generated reports used for the GE-R process.
2. **Inadequate Policies, Procedures and Related Controls Over GE-R Physical Counts.**
   - Establish and implement internal controls to ensure location discrepancies are investigated upon discovery and that the location entered in the system is the physical location of the asset, rather than the primary location of the owning activity.
   - Perform timely updates of all required data elements including location, condition, and other necessary elements. Implement policies and procedures to record asset transfers, dispositions and losses in a timely manner.
   - Establish policies and procedures and implement an annual physical inventory of assets, to include verification of property existence, data accuracy and completeness, and require updates of specific information about the asset, such as custodian name and physical location.
   - Reconcile to the system of record and make all relevant updates following the performance of physical inventory procedures.
   - Complete system adjustments within a timely manner when assets are found or lost in between physical inventory periods.

EY Building a better working world

- Establish and implement internal controls to validate that the complete population of capital GE-R is accurately recorded and presented in the financial statements and to detect any capital GE-R that is not recorded in the financial statements.

3. **Lack of Policies and Procedures, Including Internal Controls to Effectively Implement Accounting Standards.**
   - Design policies and procedures to value the DON's GE-R in accordance with SFFAS 50 and SFFAS 6.
   - Document a detailed implementation plan for SFFAS 50 and SFFAS 6, which includes a detailed description of the process, as well as the proposed application of SFFAS 50 and SFFAS 6.
   - Exercise oversight and perform reviews of valuation calculations for all asset types to ensure accuracy and compliance with GAAP.
4. **Inadequate Controls over Financial Reporting of GE-R.**
   - Establish and implement internal controls to ensure that all reportable GE-R assets are included in the PP&E balance and the related footnote.
   - Consolidate all GE-R into a single system of record for both accountability and financial reporting.
   - Require that each BSO submit accurate and complete asset populations in a timely manner.
   - Implement policies and procedures to require that variances identified are investigated and resolved prior to preparation and reporting of the financial statements and related footnotes.

V. Expenses and Accounts Payable

AP represents the amount owed to third parties by the DON for goods and services received and expenses includes all costs that are incurred but not capitalized on the balance sheet. Expenses and AP include key subprocesses from the procure to pay (P2P) business processes, including Contract Vendor Pay (CVP), Military Standard Requisitioning and Issue Procedures (MILSTRIP), Transportation of People (TOP), Transportation of Things (TOT), and Reimbursable Work Orders – Grantor (RWO-G). In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenses applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The DON's current policies, procedures, and key controls over its end-to-end expense and AP processes do not address financial reporting risks, leading to misstatements in amounts reported within the financial statements. Specifically, we noted the following issues during our testing:

1. **Lack of Effectively Designed Controls in the Expense and AP Process.** Controls over the expenses and AP process are not properly designed as detailed below:

EY Building a better working world

Posting of Expenses and AP

There is a lack of controls to ensure that expenses and AP are posted timely or at the appropriate amount, or to ensure that they are adjusted upward or downward when needed, in both Navy ERP and legacy systems. Specifically, expenses and AP were not posted in a timely manner for the CVP, MILSTRIP, TOP, and TOT processes.

Receipt and Acceptance

There is a lack of sufficient controls to ensure that goods and services are reviewed, received and accepted prior to payment in both Navy ERP and legacy systems. Specifically, the DON was unable to provide receipt and acceptance support for CVP, RWO-G, and TOT transactions.

2. **Lack of Sufficient AP Control Environment.** The DON is unable to record AP intragovernmental transactions in an accurate, complete, and timely manner. In addition, the DON lacks consistent procedures to monitor outstanding AP. Further, an entity-wide process has not been implemented to calculate an AP accrual for goods and services received prior to receiving an invoice.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of Effectively Designed Controls in the Expense and AP Process**.
   - Assess the system interfaces to determine whether expenses and payables are able to post automatically and develop or fix those interfaces as appropriate.
   - Post payables manually that cannot be posted via interface timely.
   - Identify the unsupported transactions and determine whether an adjustment is necessary to accurately state the AP and budgetary balances in accordance with the timeline provided by the PCM:
     - Develop and implement procedures to ensure transactions are posted accurately and timely.
     - Develop and implement document retention policies for receipt and acceptance procedures.
   - Implement additional monitoring of when the receipt of an order is received to when the receipt is uploaded into the general ledger system to ensure timely recording of the expense and payable:
     - Enhance review over three-way match controls.
2. **Lack of Sufficient AP Control Environment.**
   - Increase leadership communication across commands to ensure that controls are executed consistently.
   - Document policies and procedures to implement an in-depth process to estimate accrued AP and establish monitoring procedures over the AP estimation process.

VI. Revenue, Accounts Receivable, and Unfilled Customer Orders

Revenue, AR, and Unfilled Customer Orders include amounts earned by the DON for the sale of goods and services provided to the Navy GF, other DoD and federal agencies, and the public. The DON's Revenue, AR, and Unfilled Customer Orders fall within the scope of the Reimbursable Work Order – Performer (RWO-P) process. Revenue is recognized based on rates charged to customers for those goods and services that are developed as a part of the Rate Setting Process. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that revenues applicable to the agency operations are properly recorded and accounted for to permit the preparation of reliable financial reports and maintain accountability of assets. Per U.S. Code Title 10 section 2208, charges for goods and services provided for an activity through a WCF shall include the amounts necessary to recover the full costs of the goods and services provided for that entity. Inadequate procedures over the RWO-P process has led to the following control weaknesses that could lead to misstatements in agency reports used for the management of the organization as well as the financial statements:

1. **Lack of or Inadequate Documentation of RWO-P Process Accounting Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the RWO-P process are not accurately or completely documented, including the lack of adequate documentation of its methodology for calculating the Allowance for Doubtful Accounts (AFDA) and related write-offs. As a result, the RWO-P process is executed inconsistently across the organization.
2. **Ineffective or Inadequate RWO-P Procedures.** Procedures do not exist, including internal controls over sales orders outsourced to third parties, identification and elimination of intra-Treasury Appropriation Fund Symbol transactions, which have resulted in misstatements on the financial statements, and recording and monitoring (including segregation of duties) of reimbursements the DON receives from the DoD Foreign Military Sales (FMS) program.
3. **Lack of Effectively Designed Controls in the RWO-P Process.** Controls over the RWO-P process are not effectively designed. Specifically, the DON has not:
    - Implemented a comprehensive review over incoming sales order funding documents recorded in the general ledger to determine validity and accuracy prior to acceptance.
    - Designed sufficient review controls to review billing files and correct variances prior to certification by DFAS.
    - Designed adequate procedures around RWO-P close-out. Specifically, controls for Unfilled Customer Orders are not designed to ensure that all terms and requirements have been met prior to close out and are not closed-out in a timely manner after the work is completed.
    - Designed controls around funds collected to validate collections reconcile back to the performance of work, provision of goods, or are recorded the period in which the services or goods were provided.
    - Designed controls to ensure appropriate reimbursement has been collected when costs are incurred in the performance of services or when goods are provided.

    - Designed monitoring and oversight controls for the RWO-P process, increasing the risk that reimbursable agreements are invalid and recorded incorrectly in the general ledger.
4. **Inadequate Controls over Financial Reporting of Revenue.** DON lacks policies, procedures, and related controls to ensure revenue transactions are in compliance with accounting standards. Specifically, revenue is not recorded when services or goods are provided, but instead, recorded when bills are issued in the general ledger. In addition, advance payments and unfilled customer order refunds are incorrectly recorded due to posting logic issues and documentation to support recorded transactions is not available.
5. **Lack of or Inadequate Controls over the Rate Setting Process.** Annually, the DON establishes rates that it will charge its customers, in the future, to recover the full costs of the goods and services sold. The DON lacks adequate controls over this manually intensive process. There are no documented policies or procedures including internal controls related to cash management, price updates or the calculation of rates charged to customers. In addition, assumptions used in the development of pricing factors used in the determination of rates are incomplete and/or inadequate, and the methodology for the application of historical and actual costs in the determination of rates is inconsistently applied across the organization.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Lack of or Inadequate Documentation of RWO-P Process Accounting Policies and Procedures, including Controls.**
    - Perform an assessment of the RWO-P end-to-end process, including AFDA, to ensure all distinct systems, processes, procedures, and key controls are documented in the PCM. The PCM should include all financial statement assertions, key control process owners, key supporting documentation, and applicable general ledger systems and data interfaces in the RWO-P process, including AFDA. The end-to-end AFDA process should include the collection of AR from the field level accounting systems to the creation of the field level AR detail, the AR scoping methodology, and the calculation of the AFDA.
    - Develop and implement policies and procedures to validate that the RWO-P process, including AFDA, is uniformly and consistently executed.
        - Develop processes and procedures for AR write-offs and ensure sufficient management review controls are in place to validate entries recorded are appropriate.
2. **Ineffective or Inadequate RWO-P Procedures.**
    - Perform an independent assessment of the Order Fulfillment end-to-end process to ensure all distinct processes, procedures, financial transactions, financial statement assertions and key controls are completely and accurately documented in the PCM:
        - Develop clearly defined roles and responsibilities for monitoring outsourced sales orders to ensure they are appropriately accounted for within Navy ERP as business events occur.

EY Building a better working world

   - Develop and implement a control to review transactions that have been cancelled by a third-party to determine the appropriateness of the transactions and perform follow-up as necessary.
- Design, document, and implement control procedures to ensure that key aspects of an event are properly segregated amongst personnel when processing an internal FMS RWO-P:
   - Implement non-automated review procedures to ensure the validity of FMS RWO-P documents and procedures to monitor funding within the budget of each command.
- Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.

3. **Lack of Effectively Designed Controls in the RWO-P Process.**
   - Design, document and implement detailed control procedures in the RWO-P process to require all relevant data elements are included on the reimbursable documentation and entered into the general ledger systems. Additionally, implement appropriate monitoring over the execution of the agreements including the billings, collections and closeout cycles.
   - Develop automated controls and appropriate system interfaces as a part of the implementation of a system solution for intragovernmental transactions such as Government-Invoicing.
   - Implement comprehensive review controls to validate that policies and procedures for the RWO-P closeout process are being consistently applied across BSOs.
4. **Inadequate Controls over Financial Reporting of Revenue.**
   - Develop and implement policies and procedures to require revenue be recognized timely and in the appropriate period as well as recorded accurately including procedures for revenue accruals and management review controls.
   - Perform a detailed review of RWO-P business processes, including advances from others, and respective posting logic to identify and address all non-compliant processes and posting:
     - Update system posting logic to comply with appropriate accounting guidance for non-compliant processes.
     - Update policies and procedures to outline the appropriate use of RWO-P transactions as well as how to appropriately account for other types of cash receipts that are not RWO-P.
     - Develop policies and procedures to ensure corrections for customer refunds or credits are timely recorded.
5. **Lack of or Inadequate Controls over the Rate Setting Process.**
   - Perform a detailed assessment of the Rate Setting Process with DON Office of Financial Management and Budget (FMB) and the BSOs to identify and document processes, procedures, systems and data interfaces, system generated reports, process owners, key control points, federal regulations and financial statement risks and relevant assertions. Develop and implement:
     - Oversight procedures to ensure BSOs are properly establishing and charging approved rates to comply with laws and regulations.
     - Policies and procedures for FMB and BSOs to review, assess, and consistently oversee the cash management process.
     - Policies and procedures for the BSOs to review, analyze, and consistently utilize actual cost data in the calculation of the stabilized rates.
     - Procedures to review and evaluate any estimated costs on a timely basis.
     - Monitoring controls to ensure information submitted to DON management is complete and accurate.
   - Perform an analysis to determine the appropriateness of the current assumptions used in the calculation of the pricing factors.

FINANCIAL SECTION US NAVY WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

EY Building a better working world

VII. Budget Execution and Undelivered Orders

Budget execution represents the use of funds, authorized by Congress and apportioned by OMB, from the time the funds are received through the outlay and reporting of those funds. UDOs represent the amount of goods or services ordered which have not been received. In accordance with FMFIA, management is responsible for establishing and maintaining internal controls that provide reasonable assurance that expenditures applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial reports. The current procedures over the end-to-end budget execution process, including recognition and reporting of UDOs and the related execution of funding as performed by the DON Office of Financial Management and Budget, do not address financial reporting and budget management risks and could lead to misstatements in amounts reported within the financial statements as detailed below:

1. **Lack of or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.** The end-to-end processes, procedures, and key controls for significant portions of the budget execution process are not accurately or completely documented. In addition, there is no enterprise-wide policy and related procedures for recording bulk obligation estimates. Estimates are not reviewed and adjusted periodically as execution data becomes available, leading to the potential loss of resources as unneeded funding cannot be reprogrammed timely. Additionally, the estimates do not have adequate analysis to support their recording.

   Funds Control

   - The DON lacks documented policies and procedures over the receipt and distribution of DON direct appropriations. Additionally, DON lacks documented policies and procedures over the realignment and reorganization of business units.
2. **Lack of or Inadequate Budget Execution Procedures.** The DON does not have effective policies and procedures in place to ensure that all stakeholders prepare and retain consistent

and sufficient supporting documentation to support budget execution transactions. Specifically, the DON was unable to provide sufficient supporting documentation to justify transactions posted and the associated UDO balances. Additionally, procedures outlining the appropriate use of reimbursable agreements and the identification and elimination of intra-appropriation transactions have not been established. In some cases, the lack of procedures has resulted in misstatements on the financial statements.

3. **Lack of Effectively Designed Controls in the Budget Execution Process.** Controls over the budget execution process are not effectively designed as detailed below:

   Posting of Obligations

   - There is a lack of controls to ensure that obligations are posted timely or at the appropriate amount in both Navy ERP and legacy systems.

   Monitoring of Obligations

   - There is a lack of controls to ensure obligations are monitored appropriately throughout their period of availability, including the execution of funding against obligations.
   - The DON lacks appropriate review of dormant obligations and does not timely de-obligate when execution against an agreement ends. Specifically, for agreements that have had no execution against them for over 90 days, the DON was unable to provide sufficient evidence that a review occurred to confirm the validity of the obligation. Lack of timely de-obligation of agreements overstates the obligated balance and understates available funds that can be used by the DON for mission critical expenditures.

   Funds Control

   - The DON lacks proper controls over budget authority. The DON does not effectively record budget authority within the general ledger nor reconcile field level budget information to supporting documentation and the financial statements. For example, the DON does not reconcile funding authority reflected within its general ledger systems, including legacy systems, to the financial statements. In addition, the DON does not research and reconcile variances identified between the field level budget information and the supporting documentation in timely manner.

Recommendations

Consider the following corrective actions related to the deficiencies identified:

1. **Lack of or Inadequate Documentation of Budget Execution Policies and Procedures, including Controls.**
   - Complete the PCM for the budget execution process to document a complete and accurate end-to-end process for the entirety of the life cycle, including the initiation, recording, processing, and reporting of transactions:
     - The PCM should include all key controls, process owners, data interfaces and federal regulations followed. Additionally, it should include a complete list of all input documents, applicable systems and system-generated reports used.

   - Implement a DON-wide policy requiring obligation estimates be recorded and documented.
   - Ensure that OUSD and DON stakeholders are consulted on the development of process documentation for receipt and distribution of direct DON WCF Appropriations. Additionally, develop standard procedures and controls to ensure accurate and timely recording.
   - Ensure that relevant stakeholders are consulted on the development of process documentation to timely close abnormal balances as a result of an activity closure or realignment.
   - Develop and implement standard procedures and monitoring controls to ensure accurate and timely identification of abnormal balances so that additional funding can be requested on a timely basis. Controls should monitor and prevent further abnormal balances.

2. **Lack of or Inadequate Budget Execution Procedures.**
   - Increase communication amongst various P2P stakeholders to ensure sufficient and complete documentation is readily available and consistently provided as part of all documentation requests for the budget execution process:
     - Evaluate, identify, and mitigate key gaps and inconsistencies in current document retention policies and procedures.
   - Discontinue the use of intra-appropriation reimbursable orders or ensure the intra-appropriation activity is properly eliminated as not to misstate the financial statements.

3. **Lack of Effectively Designed Controls in the Budget Execution Process.**
   - Evaluate existing controls to ensure that the appropriate monitoring procedures are in place, including record retention policies.
   - Evaluate existing policies and procedures over the UDO process to ensure that the appropriate procedures are in place for the timely de-obligation of funds.
   - Focus efforts on monitoring active obligations before they become dormant including the related expenditures. This will increase visibility into funds actually needed for valid business purposes versus funds that can be de-obligated and used for other mission critical needs.
   - Develop and implement procedures to reconcile balances recorded in the field-level general ledger to those reported in the financial statements and to supporting documentation and explain or resolve variances on a timely basis.
   - Ensure that end-to-end process documentation related to the Funds Receipt and Distribution processes include procedures and considerations about financial reporting for all relevant general ledger accounts in the financial statements.

VIII. Entity Level Controls – Oversight and Monitoring

DoD Instruction 5010.40 requires DoD entities to comply with the requirements of the FMFIA and OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and*

Internal Control. FMFIA requires federal entities to establish internal controls in accordance with the GAO Green Book. The GAO Green Book defines entity level controls as controls that have a pervasive effect on an entity's internal control. It establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. In accordance with the GAO Green Book, management must effectively design, implement, and operate each of the components of internal control for the components to be effective. The DON has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book and OMB Circular A-123 requirements as described below:

1. **Inadequate Control Environment.** An entity's control environment provides the discipline and structure to help the entity achieve its objectives. According to the GAO Green Book, a key principle in establishing an adequate control environment is the appropriate documentation of the internal control system including the five components of internal controls. The GAO Green Book further states that this type of documentation provides a means to retain organizational knowledge and mitigate the risk of having that knowledge limited to a few personnel. The documentation also provides a means to communicate, as needed, that knowledge to third parties, such as external auditors. A lack of documentation identifying process controls can lead to inadequate communication to those responsible for control performance, as well as inappropriate execution and monitoring of controls. We noted the following deficiencies in the DON's control environment:

   Entity Level Controls and Documentation

   - The current control environment is ineffective due to inadequate design of entity level controls and lack of proper end-to-end documentation of key business processes including internal controls.

   System Consolidation and Data Migration

   - According to the GAO Green Book, management should document internal controls to meet operational needs. Documentation of controls, including changes to controls, is evidence that controls are identified, documented, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity. The DON does not have adequate documentation over the internal controls supporting system consolidations and data migration activities occurring on DON systems. Due to the lack of adequate documentation and governance, there is a lack of communication to the responsible BSO and financial organizations overseeing system consolidation and data migration efforts, as well as inadequate monitoring of the activities performed. Specifically, the identified system consolidation and data migration weaknesses that represent a significant risk to the DON financial management information systems environment include the following:
     - Overarching system consolidations governance (e.g., policies, procedures, and minimum activities), to include monitoring does not exist.
     - Overarching legacy system decommissioning procedures and/or guidance across all DON functional areas have not been developed to manage and verify the appropriate shut-down and decommissioning of legacy systems no longer in use by DON organizations, Commands, and/or BSOs.
     - Requirements and/or evidence to demonstrate accounting functions are no longer being performed for migrated BSOs when the legacy system remains in use by other organizations/BSOs.
     - Migration specific project plans governing the migration activities for system consolidation efforts, to include but not limited to, the impacted legacy system, future state system, and BSOs do not exist.
     - Pre-migration conversion testing to demonstrate data designated to be migrated converted successfully and without error, or that any errors identified are resolved and retested, or analyzed, and determined to not pose a risk to the completeness and accuracy of the migration results are inadequate.

2. **Lack of Risk Assessments.** According to the GAO Green Book, management should assess the risks facing the entity as it seeks to achieve its objectives by identifying, analyzing, and responding to risks related to achieving the defined objectives. A comprehensive entity level risk assessment does not exist, nor has the DON fully identified financial reporting risks for the majority of its key business processes.

3. **Inadequate Monitoring Controls.** According to the GAO Green Book, management should establish and operate activities to monitor the internal control system, evaluate results, and remediate identified internal control deficiencies on a timely basis. In addition, it states that management may engage third parties, such as service organizations, to perform certain operational processes for the entity; however, it retains responsibility for monitoring the effectiveness of internal control over the assigned processes performed by service organizations. OMB Circular A-123 requires that management evaluate the effectiveness of internal controls annually using the GAO Green Book. The current control environment lacks adequate monitoring controls to evaluate the effectiveness of the internal controls for the majority of its key business processes. In addition, as noted below, the DON does not have proper oversight of service organizations and other third parties:

   DFAS

   - DFAS performs key financial reporting controls on management's behalf; however, DFAS procedures are not designed to verify the completeness and accuracy of the data within the reports utilized. Additionally, compensating controls do not exist to mitigate the risks posed by DFAS's control weaknesses.

   Contractors

   - The DON does not have adequate oversight of contractors that hold property on its behalf. In addition, there is inconsistent reporting by contractors regarding the property that they hold, leading to unreliable asset reporting which can have an impact on the DON's operations.

Recommendations

Consider the following corrective actions related to the conditions described above:

1. **Inadequate Control Environment.**

   Entity Level Controls and Documentation

   - Complete the design and emphasize the importance of an A-123 program at all levels of the organization from the DON leadership. This is necessary to bring visibility, education and support to the program from across the organization and at the highest levels of leadership.
   - Identify, document and communicate roles and responsibilities throughout the DON as they relate to the implementation of an A-123 program. Ensure the proper groups and personnel that are involved are trained at the appropriate levels to produce the most effective results. Integrate financial management (FM) and information technology (IT) remediation efforts to achieve a more efficient and effective program.
   - Develop, document and maintain supporting documentation as a part of an A-123 program and for Enterprise Risk Management to evidence the development of management control plans, performance of risk assessments, ongoing monitoring, development of corrective action plans and tracking of progress towards remediation.

   System Consolidation and Data Migration

   - Develop, document, and implement policy and procedures that define governance structures, minimum activities, and include an enterprise-wide monitoring program for all system consolidations and data migrations efforts.
   - Strengthen the integration and collaboration between IT and FM organizations throughout the system consolidation lifecycle to promote a holistic, continuous evaluation, and understanding of risk as part of the development and implementation of the Department-level governance and system consolidation enterprise-wide monitoring program.
   - Develop, document, and implement system decommissioning procedures and requirements that effectively manage, control, and verify the appropriate shut-down and decommissioning of legacy systems no longer in use.
   - Develop and implement procedures that effectively verifies all financial activities and transactions are no longer being performed or recorded in a legacy system and develop a checklist that can be used to validate that the procedures established have been appropriately executed, effectively demonstrate that the legacy system is no longer performing accounting functionality, and serve as evidence for investigative purposes.
   - Include requirements that migration-specific project plans (specific to each migrating/impacted BSO, legacy system, and future state system) are developed, implemented, and adhered to.
   - Develop and document procedures for conducting the system consolidation conversion documentation tracker process that includes clearly documenting results of all iterations of all pre-migration conversion testing, analysis performed by appropriate stakeholders in situations where errors are identified, and evidence demonstrating that significant errors identified are resolved and re-tested as needed prior to migration.

2. **Lack of Risk Assessment.**

   - Develop a policy to include proper detail and guidance for conducting the risk assessment process, including:
     - A process to review all aspects of the risk management processes at least once a year.
     - Review of the previous risks identified with appropriate frequency.
     - Provisions for alerting the appropriate level of management to new or emerging risks, as well as changes in already identified risks, so that the change can be appropriately addressed.

3. **Inadequate Monitoring Controls.**

   DFAS

   - Assess policies and procedures governing oversight of third-party service providers and identify the appropriate level of oversight and monitoring required to ensure accurate and complete reporting.
   - Design management review controls related to actions performed by DFAS that are appropriate and/or develop procedures to mitigate the management review control risks identified. Retention of adequate documentation evidencing the procedures performed during their review should include, but is not limited to:
     - Procedures performed/re-performed.
     - Verification that the data transferred from a system of record to an End User Computing tool, such as Excel, is not lost, added, or changed.

   Contractors

   - Identify the level of oversight required of contractors that have government property in their custody and develop the appropriate policies and procedures to implement the actions necessary for consistent and effective oversight and monitoring.
   - Implement changes to contracts to allow for contractors with property in their custody to accurately report the property in accordance with federal accounting standards. Include in the contracts the actions necessary for government personnel to monitor the reports and data presented for accuracy.

Financial Information Systems

The DON needs to continue to focus on implementing a robust internal control environment and information security program that is designed and operating effectively to mitigate key financial audit risks. Consequently, a prioritized, risk-driven effort is still necessary to remediate deficiencies in the areas of Access Controls, SoD, Configuration Management, and Interface Processing. Our assessment of the IT controls and the computing environment focused on a subset of financially significant applications that included general ledger systems, feeder systems and

EY
Building a better working world

operational systems. The following table outlines the number of deficiencies identified across the 31 systems in scope for the WCF:

System Type	FY20 DON Financially Significant Systems – IT Internal Controls Deficiencies				
	Security Management	Access Controls/ SoD	Configuration Management	Interface Processing	Totals
General Ledger Systems	21	73	24	42	160
Feeder and Operational Systems	33	224	120	115	492
Totals	**54**	**297**	**144**	**157**	**652**

Based on the results outlined above, we noted the following:

- 92% of all control deficiencies identified across all system types map to high-risk control domains (i.e., access controls, SoD, configuration management and interface processing)
- 46% of control deficiencies are a result of Access Control/SoD deficiencies
- 22% of control deficiencies are a result of Configuration Management deficiencies
- 24% of control deficiencies are a result of Interface Processing deficiencies

A subset of the deficiencies identified were high-risk, which collectively constitute a material weakness in the design and operation of information systems controls. We reviewed each finding individually as well as in aggregate. Based on our review and analysis of the findings in aggregate, we have identified three distinct material weaknesses related to information system controls.

We have outlined the three IT material weaknesses below:

- Access controls/Segregation of Duties
- Configuration management
- Interface processing

Each of the IT material weaknesses are discussed further below.

IX. Access Controls/Segregation of Duties

Access controls include those controls related to protecting system boundaries, user identification and authentication, authorization, protecting sensitive system resources, audit and monitoring, and physical security. When properly implemented, access controls can help ensure that critical systems assets are safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and/or disclosed.

The identified access control weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

EY
Building a better working world

- Complete and accurate system generated populations of users were not consistently available, or evidence to support this was not provided, to include source and level of access granted.
- Definition of financially significant transactions and resources has not been performed and/or lacks financial oversight.
- User access provisioning to include initial access provisioning, modification, and removal were not performed in accordance with defined requirements, timelines, and with sufficient detail to confirm access currently granted in the system was commensurate with access approved and required for the user's business function.
- User access recertification/periodic user access reviews were not performed to consistently evaluate both the need for access and the level of access provisioned.
- Monitoring sensitive user activities, including activities of privileged users, were not documented, not being performed, or not configured appropriately within systems.
- Audit logging information was not protected against unauthorized access and modification, as well as not being retained for the audit period.
- Definition and control of security violations and monitoring, to include required follow on actions and removal of access, was inconsistent.

An effective control environment guards against a particular user having incompatible functions within a system. SoD controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations without detection and thereby conducting unauthorized actions or gaining unauthorized access to assets or records.

The identified SoD weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- Cross-application SoD analysis has not been performed across key financial systems to determine the significance and pervasiveness of these types of SoD conflicts. Additionally, cross-application SoD are not considered when provisioning user access.
- SoD matrices or equivalent were not consistently documented, inclusive of all functional roles, and/or not mapped effectively to the system access associated with the functional roles.
- Assigning of conflicting roles during the access provisioning process could not be prevented, and for known conflicts where SoD concerns were identified, there was a lack of documentation for business rationale and subsequent monitoring of a user's activity.
- Multiple systems had a significant number of administrator users (i.e., database administrators, developers) able to complete an entire functional process by inputting, processing, and approving transactions.

Recommendations

Consider the following corrective actions related to the conditions described above:

Building a better working world

- Systematically generate population of users and incorporate completeness and accuracy procedures into review controls to confirm a holistic evaluation of the user base. Implement monitoring and review controls for users with elevated access privileges.
- Define transactions and resources that are financially significant and obtain approval from the appropriate level of IT and financial oversight.
- Establish and consistently follow processes and controls related to user account management and SoD, including the entire life cycle from access provisioning to recertification, modification of access, inactivity restrictions, and termination procedures.
- Segregate roles and where conflicting roles are required or unavoidable, document business rationale, and monitor activities of users.
- Evaluate cross-application SoD to identify potential conflicts for users accessing multiple systems.
- Conduct appropriate analysis to confirm functional user access is tied to the appropriate logical permissions within the systems and confirm SoD is enforced.
- Re-enforce/disseminate guidance as it relates to defining required security violation monitoring procedures and establish governance around the frequency for which security violations should be escalated, to whom, and management's required actions.

X. Configuration Management

Configuration management involves the identification and management of security features for all hardware and software components of an information system at a given point and systematically controls changes to that configuration during the system's life cycle. By implementing configuration management controls, the DON can ensure that only authorized applications and software programs are placed into production through establishing and maintaining baseline configurations and monitoring changes to these configurations. Weaknesses in such controls can compromise the integrity of sensitive data and increase the risk that such data may be inappropriately used and disclosed.

The identified configuration management weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- Complete and accurate system generated populations of changes made to the production environments are not captured nor available to support internal controls and monitoring. This includes code changes, direct data changes, configurable settings within the application, and changes to interfaces.
- Logging and monitoring controls have not been implemented to identify unintentional or unauthorized changes made to the application, database, interfaces, and data.
- Environment is not segregated; developers have access to the production environment. Additionally, access to source code is not properly controlled.
- Configuration changes are not properly reviewed, approved, and documented.

FINANCIAL SECTION US NAVY WORKING CAPITAL FUND FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

Building a better working world

- There is no management review or monitoring of third-party providers, who perform many aspects of the configuration management functions for the relevant applications, to ensure compliance with the currently approved configuration management process.
- Inadequate governance and requirements during system conversion/consolidation activities resulted in critical financial reporting discrepancies and risks to the financial statement.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Identify complete and accurate populations of configuration changes in order to monitor changes and determine only authorized and approved changes are being applied to production.
- Segregate access between development and production environments.
- Restrict access to source code and document authorization and business need for those that require this access to perform their job roles and responsibilities.
- Establish controls to monitor third party support organizations associated with the configuration management of the DON's applications.
- Establish audit logging capabilities in order to monitor changes made to the application, database, interface and data to ensure they are authorized.
- Implement governance as it relates to system conversions, such that adequate testing and remediation of known errors is performed by both IT and Financial stakeholders prior to the conversion /go-live.

XI. Interface Processing

Interface controls consist of those controls over the timely, accurate, and complete processing of information between applications on an ongoing basis. Weaknesses in interface controls increase the risk related to data discrepancies, inability to determine data transfer completeness, timeliness, and accuracy of data transmitted that ultimately impact the reliability of data transfer between financial management information systems.

The identified interface control weaknesses that represent a significant risk to the DON financial management information systems environment include the following:

- A complete population of interfaces, systematically generated or systematically validated, could not be provided to support the complete and accurate processing of the DON transactions.
- Edit and validation checks are not consistently implemented across financially significant interfaces to prevent the processing of duplicate or inaccurate data.
- File-level reconciliations are not being performed between source and target systems to ensure completeness and accuracy of processing.

EY
Building a better working world

- Logs of interface processing activities are not retained to support subsequent auditing and monitoring; error reporting for failed interface processing activities has not been implemented in some systems.
- Interface files are not protected from unauthorized access and modification prior to processing through the use of secure transmission mechanisms.
- Remediation of identified errors in interface processing are not completed in accordance with defined requirements, timelines and with sufficient detail to confirm remediation.

Recommendations

Consider the following corrective actions related to the conditions described above:

- Conduct an appropriate analysis and implement procedures to confirm that the population of interfaces is complete and accurate.
- Implement stronger systemic checks for completeness and accuracy of interface file processing, to include tracking and logging procedures and protection from unauthorized access.
- Conduct an appropriate analysis of a complete and accurate population of edit checks and validations to then determine which are financially significant within the interface process. After this analysis, determine if the interface files are being subject to appropriate validation and edit checks and that they are operating as designed.
- Implement controls to confirm that the information received or sent from a target to source application is complete, accurate and consistently received.
- Test system interfaces in an end-to-end manner for the DON to gain reasonable assurance that system consolidation efforts will retain desired/intended functionality.
- Implement consistent controls to log interface activity and monitor these logs to allow for timely remediation of errors associated with the transmission of data used in financial reporting.
- Protect data files transmitted via interfaces from inadvertent or intentional access or modification prior to data processing.

EY
Building a better working world

Ernst & Young LLP
1775 Tysons Boulevard
Tysons, VA 22102

Tel: +1 703 747 1000
Fax: +1 703 747 0100
ey.com

Report of Independent Auditors on Compliance and Other Matters Based on an Engagement to Audit the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Secretary of the United States Department of the Navy and the
Inspector General of the Department of Defense

We were engaged to audit, in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*, the financial statements of the Working Capital Fund of the United States Department of the Navy (DON), which comprise the consolidated Balance Sheet as of September 30, 2020, and the related consolidated Statements of Net Cost, Changes in Net Position, and the combined Statement of Budgetary Resources for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 15, 2020. Our report disclaims an opinion on such financial statements because the DON was not able to provide sufficient appropriate audit evidence due to matters discussed further in the Basis for Disclaimer of Opinion paragraph.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of the DON, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements as well as the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA) (P.L. 104-208). However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03, as described below. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, other instances of noncompliance or other matters may have been identified and reported herein.

Our Report on Internal Control over Financial Reporting dated December 15, 2020, includes additional information related to the financial management systems and internal controls that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations to the specific issues presented.

FFMIA

Under FFMIA, we are required to report whether the DON's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. The results of tests disclosed instances in which the DON's financial management systems did not substantially comply with federal financial management systems requirements, applicable federal accounting standards or the USSGL.

(a) Federal financial management system requirements

As referenced in the Fiscal Year (FY) 2020 Department of Navy Statement of Assurance, the DON identified that financial systems and financial portions of mixed systems do not substantially meet the requirements of FFMIA or OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (Circular A-123) Appendix D.

EY also identified this material weakness as part of the Financial Information Systems material weakness, contained in the Report on Internal Control over Financial Reporting, where we identified noncompliance with federal financial management system requirements for multiple systems. Weaknesses identified include those associated with access controls, segregation of duties, configuration management, and interface processing. These financial system deficiencies prevent the DON from being compliant with federal financial management system requirements and inhibit the DON's ability to prepare complete and accurate financial reporting.

(b) Noncompliance with applicable federal accounting standards

As referenced in the FY 2020 Department of Navy Statement of Assurance and Note 1 to the financial statements, the DON identified that the design of financial and non-financial systems does not allow the DON to comply with applicable federal accounting standards, including not being able to collect and record financial information on an accrual accounting basis. EY also identified noncompliance with federal accounting standards during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

(c) Noncompliance with USSGL posting logic at the transaction level

As referenced in the FY 2020 Department of Navy Statement of Assurance, the DON identified that the design of financial systems does not allow the DON to comply with USSGL at the transaction level. EY also identified noncompliance with USSGL posting logic during our testing, and those findings are included in our Report on Internal Control over Financial Reporting.

FMFIA

Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires federal entities to establish internal controls, perform ongoing evaluations of the adequacy of the entity's system of internal control, and prepare related reports. The Government Accountability Office's (GAO's) *Standards for Internal Control in the Federal Government* (commonly referred to as the GAO Green Book),

issued under the authority of FMFIA, establishes five components of internal control: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. To determine if an entity's internal control system is effective, the Green Book requires management to assess the design, implementation, and operating effectiveness of the five components of the entity's internal control system.

The DON has not yet implemented a formal internal control program that would allow it to substantially comply with FMFIA and the related GAO Green Book requirements, leading to inadequate control environment, risk assessment and monitoring processes.

Management's Response to Findings

DON's responses to the findings identified in our engagement and relevant comments from the DON's management responsible for addressing the noncompliance are provided in their accompanying letter dated December 15, 2020. Management's response was not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on the entity's compliance. This report is an integral part of an engagement to perform an audit performed in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

December 15, 2020

RESPONSE TO INDEPENDENT AUDITORS' REPORT

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

December 15, 2020

Ernst &Young, LLP
(Attention: Mr. John F. Short, Partner)
1775 Tysons Boulevard
Tysons, VA 22102

Dear Mr. Short:

We reviewed the U.S. Navy Working Capital Fund Audit Report prepared by Ernst & Young, LLP for the audit of the U.S. Navy Working Capital Fund and appreciate the recommendations to continue improving our financial operations. The Navy acknowledges and concurs with the material weaknesses and disclaimer of the opinion.

The ongoing Coronavirus 2019 pandemic presented many unforeseen obstacles to the audit. We appreciate your flexibility in continuing the execution of audit procedures during Fiscal Year (FY) 2020 in spite of these obstacles. The lessons learned from the audit, and the recommendations provided within the report, will continue to improve our ability to support the future audits.

The Department of the Navy's (DON) financial management transformation strategy is built around three complementary elements: audit, budgetary reform, and consolidation of systems. In FY20, we remediated Contract Authority. We also developed the Navy Audit Roadmap to document key milestones and tasks necessary to resolve our material weaknesses and achieve an unmodified audit opinion by FY27. This integrated strategy will ensure we stay focused on the activities required to meet that long-term goal. Each year, we will sustain improvements and continue building on milestones achieved. FY21 priorities include:

- Working Capital Fund Inventory – demonstrate accountability over inventory assets and improve oversight at both organic and vendor locations;
- Fund Balance with Treasury – sustain progress made to reduce suspense and statement of differences balances, and establish a standard DON-wide reconciliation process to produce an auditable trial balance;
- Financial Reporting – implement internal controls over estimates, accruals, and the reporting of asset balances;
- Budget Execution – improve the end-to-end budget process to include oversight of obligations and expenditures, timely recordation, and funds control; and
- Systems Consolidation – continue to consolidate legacy financial accounting and feeder systems into Navy Enterprise Resource Planning.

Findings from the annual financial statement audits are of enormous value to us. Returns through cost savings and cost avoidance enable re-investments in operational readiness that directly benefit our men and women serving aboard. We welcome your scrutiny and appreciate all you do to support us in the defense of our great nation.

Sincerely,

Alaleh A. Jenkins
Performing the Duties of the Assistant Secretary
of the Navy (Financial Management and Comptroller)

The Independence variant littoral combat ships USS Tulsa (LCS 16), left, USS Manchester (LCS 14), center, and USS Independence (LCS 2), right, sail in formation in the eastern Pacific. (U.S. Navy photo by Chief Mass Communication Specialist Shannon Renfroe/Released)

OTHER INFORMATION

SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

The DON has multiple ongoing Financial Management and Reporting corrective action plans. Efforts are being made to continually improve upon the implementation of completed corrective action plans. Additionally, the DON has made significant improvements in the areas of Internal Control design and Implementation to ensure effectiveness.

TABLE 1. SUMMARY OF FINANCIAL STATEMENT AUDIT

Restatement: No

Areas of Material Weaknesses	Beginning Balance	New	Resolved	Reassessed	Consolidated	Balance	General Fund	Working Capital Fund
Financial Reporting	2	0	0	0	0	2	1	1
Fund Balance with Treasury	2	0	0	0	0	2	1	1
Government Property in the Custody of Contractors	1	0	0	0	0	1	1	0
Operating Materials and Supplies – Remainder	1	0	0	0	0	1	1	0
Operating Materials and Supplies – Ordnance	1	0	0	0	0	1	1	0
Operating Materials and Supplies – Valuation	0	1	0	0	0	1	1	0
General PP&E – General Equipment – Utilities	2	0	0	0	-1	1	1	0
General PP&E – General Equipment – Remainder	2	0	0	0	0	2	1	1
General PP&E – Construction in Progress	1	0	0	0	0	1	1	0
Environmental & Disposal Liabilities	1	0	0	0	0	1	1	0
Contingent Legal Liabilities	1	0	0	-1	0	0	0	0
Expenses and Accounts Payable	2	0	0	0	0	2	1	1
Revenue and Unfilled Customer Orders	1	0	0	0	0	1	1	0
Revenue, Accounts Receivable and Unfilled Customer Orders	1	0	0	0	0	1	0	1
Budget Execution and Undelivered Orders	2	0	0	0	0	2	1	1
Entity Level Controls – Oversight and Monitoring	2	0	0	0	0	2	1	1
Inventory	1	0	0	0	0	1	0	1
Contract Authority	1	0	-1	0	0	0	0	0
Financial Information Systems – Access Controls/SOD	2	0	0	0	0	2	1	1
Financial Information Systems – Configuration Management	2	0	0	0	0	2	1	1
Financial Information Systems – Interface Processing	2	0	0	0	0	2	1	1
Total Material Weaknesses	30	1	-1	-1	-1	28	17	11

TABLE 2. SUMMARY OF MANAGEMENT ASSURANCES

The DON Financial Reporting Material Weaknesses and Corrective Actions

End-to-End Process	Areas of Material Weaknesses	Beginning Balance	New	Recategorized	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Budget-to-Report	Financial Statement Reporting and Compilation	1	0	-1	0	0	0	0	0
	Traceability and Supportability of Foreign Military Sales Transactions	0	0	1	0	0	1	1	1
	Contract Authority	0	1	0	-1	0	0	0	0
	Contingent Legal Liability	0	1	0	0	-1	0	0	0
Procure-to-Pay	Contract/Vendor Pay	1	0	-1	0	0	0	0	0
	Procure-to-Pay Process	0	0	1	0	0	1	1	1
	Financial Statement Reporting and Compilation	1	0	-1	0	0	0	0	0
	Accounts Payable	0	0	1	0	0	1	1	1
Order-to-Cash	Reimbursable Work Orders	1	0	-1	0	0	0	0	0
	Order-to-Cash Process	0	0	1	0	0	1	1	1
Acquire-to-Retire	Equipment Assets	2	0	-2	0	0	0	0	0
	Property, Plant & Equipment Valuation	0	0	1	0	0	1	1	1
	General Equipment-Remainder – Existence and Completeness	0	0	1	0	0	1	1	1
Plan-to-Stock	Inventory	1	0	0	0	0	1	0	1
	Operating Materials and Supplies	2	0	-2	0	0	0	0	0
	Operating Materials & Supplies – Remainder	0	0	1	0	0	1	1	1
	Operating Materials & Supplies – Ordnance	0	0	1	0	0	1	1	0
Multiple End-to- End Processes	Fund Balance with Treasury	1	0	0	0	0	1	1	1
	Reimbursable Work Orders	1	0	-1	0	0	0	0	0
	Budgetary Execution	0	0	1	0	0	1	1	1
	Financial Statement Reporting and Compilation	1	0	0	0	0	1	1	1
Total Financial Reporting Material Weaknesses		12	2	0	-1	-1	12	11	11

THE DON OPERATIONAL MATERIAL WEAKNESSES

EFFECTIVENESS OF INTERNAL CONTROLS OVER NON-FINANCIAL OPERATIONS (FMFIA § 2)

Statement of Assurance: Modified Assurance

End-to-End Process	Areas of Material Weaknesses	Beginning Balance	New	Recategorized	Resolved	Reassessed	Ending Balance	General Fund	Working Capital Fund
Comptroller and Resource Management	DON Oversight and Management of Improper Payments	1	0	0	0	0	1	1	1
Contract Administration	Execution of Husbanding Contracts – Husbanding Service Providers	1	0	0	0	0	1	1	1
Personnel and Organizational Management	Military Pay and Personnel	1	0	0	0	0	1	1	1
	Submission of Criminal Subject Fingerprint Cards and Reporting Disposition of Criminal Charges	1	0	0	0	0	1	1	1
Information Technology	Complex Business IT Environment	1	0	0	0	0	1	1	1
Multiple Reporting Categories	Depot Level Maintenance	1	0	0	0	0	1	1	1
	Data Protection	1	0	0	0	0	1	1	1
	Property in the Possession of Contractors	1	0	0	0	0	1	1	0
	Oversight and Monitoring	1	0	0	0	0	1	1	1
	Total Material Weaknesses	9	0	0	0	0	9	9	8

EFFECTIVENESS OF INTERNAL CONTROLS OVER FINANCIAL SYSTEMS (FMFIA § 4 AND FFMIA)

Statement of Assurance: Controls are not in place to provide Reasonable Assurance

Nonconformances	Beginning Balance	New	Resolved	Recategorized	Reassessed	Ending Balance	General Fund	Working Capital Fund
Financial Management Systems	3	0	0	0	0	3	3	3
Total System Conformance Material Weakness	3	0	0	0	0	3	3	3

COMPLIANCE WITH SECTION 803(A) OF THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)

	Agency	Auditor
1 Federal Financial Management System Requirements	Lack of compliance noted	Lack of compliance noted
2 Applicable Federal Accounting Standards	Lack of compliance noted	Lack of compliance noted
3. USSGL at Transaction Level	Lack of compliance noted	Lack of compliance noted

APPROPRIATIONS, FUNDS, AND ACCOUNTS INCLUDED IN THE PRINCIPAL STATEMENTS

General Funds	
017X0380	Coastal Defense Augmentation, Navy
017 0513	Ship Modernization, Operations and Sustainment Fund, Navy
017 0703	Family Housing, Navy and Marine Corps
017 0730	Family Housing Construction, Navy and Marine Corps
017 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
017X0810	Environmental Restoration, Navy
017 1000	Medicare-Eligible Retiree Health Fund Contribution, Navy
017 1001	Medicare-Eligible Retiree Health Fund Contribution, Marine Corps
017 1002	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Navy
017 1003	Medicare-Eligible Retiree Health Fund Contribution, Reserve Personnel, Marine Corps
017X1105	Military Personnel, Marine Corps
017 1105	Military Personnel, Marine Corps
017X1106	Operation and Maintenance, Marine Corps
017 1106	Operation and Maintenance, Marine Corps
017 1107	Operation and Maintenance, Marine Corps Reserve
017 1108	Reserve Personnel, Marine Corps
017X1109	Procurement, Marine Corps
017 1109	Procurement, Marine Corps
017X1205	Military Construction, Navy and Marine Corps
017 1205	Military Construction, Navy and Marine Corps
017 1206	Military Construction – Recovery Act, Navy and Marine Corps
017 1235	Military Construction, Naval Reserve
017X1236	Payments to Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
017X1319	Research, Development, Test, and Evaluation, Navy
017 1319	Research, Development, Test, and Evaluation, Navy
017 1320	Research, Development, Test and Evaluation – Recovery Act, Navy
017 1405	Reserve Personnel, Navy
017X1453	Military Personnel, Navy
017 1453	Military Personnel, Navy
017X1506	Aircraft Procurement, Navy
017 1506	Aircraft Procurement, Navy
017X1507	Weapons Procurement, Navy
017 1507	Weapons Procurement, Navy
017 1508	Procurement of Ammunition, Navy and Marine Corps
017X1611	Shipbuilding and Conversion, Navy
017 1611	Shipbuilding and Conversion, Navy
017 1612	National Sea-Based Deterrence Fund, Navy
017X1804	Operation and Maintenance, Navy
017 1804	Operation and Maintenance, Navy
017 1805	Operation and Maintenance – Recovery Act, Navy
017X1806	Operations and Maintenance, Navy Reserve
017 1806	Operation and Maintenance, Navy Reserve
017X1810	Other Procurement, Navy
017 1810	Other Procurement, Navy

Revolving Funds	
017X4557	National Defense Sealift Fund, Navy
017 4557	National Defense Sealift Fund, Navy

Special Funds	
017X5095	Wildlife Conservation, etc., Military Reservations, Navy
017X5185	Kaho'olawe Island Conveyance, Remediation, and Environmental Restoration Fund, Navy
017X5562	Ford Island Improvement Account
017X5630	Department of Defense World War II Commemoration Fund, Navy

Deposit Funds	
017X6001	Proceeds of Sales of Lost, Abandoned, or Unclaimed Personal Property, Navy (T)
017X6002	Personal Funds of Deceased, Mentally Incompetent or Missing Personnel, Navy (T)
017X6025	Pay of the Navy, Deposit Fund (T)
017X6026	Pay of the Marine Corps, Deposit Fund (T)
017X6228	Thrift Savings Fund, Navy
017X6434	Servicemen's Group Life Insurance Fund, Suspense, Navy
017X6502	Foreign Cooperative Projects, Navy
017X6705	Civilian Employees Allotment Account, Navy
017 6763	Gains and Deficiencies on Exchange Transactions, Navy
017X6950	Disbursing Officer Cash, Department of the Navy

Trust Funds	
017X8716	Department of the Navy General Gift Fund
017X8723	Ships Stores Profits, Navy
017X8733	United States Naval Academy General Gift Fund01

Working Capital Fund	
097X4930.002	Defense Working Capital Fund, Navy
097 4930.002	Defense Working Capital Fund, Navy

Pilots from Strike Fighter Squadron (VFA) 125 and VFA-147 are the first TOPGUN students to complete the course in the F-35C Lightning II. (U.S. Navy photo/Released)

APPENDIX

ABBREVIATIONS

Abbreviation	Definition
ADA	Anti-Deficiency Act
AFDA	Allowance for doubtful accounts
AFR	Agency Financial Report
AIO	Acquisition Integrity Office
APSR	Accountable Property System of Record
ASN (FM&C)	Assistant Secretary of the Navy, Financial Management & Comptroller
ASN (RD&A)	Assistant Secretary of the Navy (Research, Development and Acquisition)
AVM	Access Violation Management
BAH	Basic Allowance for Housing
BOMC	Business Operations Management Council
BOP	Business Operations Plan
BRAC	Base Realignment and Closure
BSO	Budget Submitting Office
BUMED	Bureau of Medicine and Surgery
BUPERS	Bureau of Naval Personnel
CAP	Corrective Action Plan
CARES ACT	Coronavirus Aid, Relief, and Economic Security Act
CBY	Charge Back Year
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act
CFMS	Command Financial Management System
CFO	Chief Financial Officer
CIO	Chief Information Officer
CIP	Construction in Process
CMC	Commandant of the Marine Corps
CNIC	Commander, Navy Installations Command
CNO	Chief of Naval Operations
CNRF	Commander, Navy Reserve Force
COLA	Cost of Living Adjustment
COMPACFLT	Commander, U.S. Pacific Fleet
CONOPS	Concept of Operations
COVID-19	Coronavirus disease 2019
CPIM	Consumer Price Index Medical
CRE	Component Reporting Entity

Abbreviation	Definition
CTC	Cost to Complete
DASN	Deputy Assistant Secretary of the Navy
DCAS	Defense Cash Accountability System
DDRS-B	Defense Departmental Reporting System-Budgetary
DERP	Defense Environmental Restoration Program
DFAS	Defense Finance and Accounting Service
DHA	Defense Health Agency
DHP	Defense Health Program
DLADS	DLA Disposition Services
DM&R	Deferred Maintenance and Repair
DoD	Department of Defense
DoD IG	Department of Defense Inspector General
DOL	Department of Labor
DON	Department of the Navy
DPAS	Defense Property Accountability System
DUSN	Deputy Under Secretary of the Navy
E&DL	Environmental and Disposal Liabilities
EGRC	Enterprise Governance, Risk, and Compliance
ELC	Entity-Level Controls
EOP	Executive Office of the President
EOU	Excess, obsolete, and unserviceable
ERM	Enterprise Resource Management
ERN	Environmental Restoration Navy
ERP	Enterprise Resource Planning
EXWC	Engineering and Expeditionary Warfare Center
FAR	Federal Acquisition Regulations
FASAB	Federal Accounting Standards Advisory Board
FBwT	Fund Balance with Treasury
FCI	Facility Condition Index
FECA	Federal Employees' Compensation Act
FFMIA	Federal Financial Management Improvement Act
FFRDC	Funded Research and Development Centers
FHIF	Family Housing Improvement Fund
FIAR	Financial Improvement and Audit Remediation
FM	Financial Management
FMB-7	Secretariat Comptroller Division
FMFIA	Federal Managers' Financial Integrity Act
FMO	Office of Financial Operations
FMR	Financial Management Regulation

Abbreviation	Definition
FRA	Fraud Risk Assessment
FRC	Fleet Readiness Centers
FRDAA	Fraud Reduction and Data Analytics Act
FRM	Fraud Risk Management
FRO	Financial Reporting Responsibilities
FSA	Field Support Activity
FY	Fiscal Year
FYDP	Future Years Defense Program
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GC	General Counsel
GE	General Equipment
GF	General Fund
GLs	General Ledger systems
GMRA	Government Management Reform Act of 1994
GONE	Grants Oversight and New Efficiency
GPP&E	General Property, Plant, & Equipment
GPRA	Government Performance and Results Act
HC	Historical Cost
HQMC	Marine Corps Headquarters
ICA	Interface Control Agreement
ICO	Internal Controls over Operations
ICOFR	Internal Controls Over Financial Reporting
ICOFS	Internal Controls Over Financial Systems
ICOR	Internal Controls Over Reporting
IdAM	Identity and Access Management
IMC	Integrated Maintenance Concept
IOC	Initial Operational Capability
IPA	Independent Public Accountant
IPIA	Improper Payments Information Act
IRM	Integrated Risk Management
IRP	Installation Restoration Program
IT	Information Technology
IUS	Internal Use Software
LAC	Latest Acquisition Cost
LLC	Limited Liability Company
LP	Limited Partnership
MAC	Moving Average Cost
MARCORLOGCOM	Marine Corps Logistics Command

Abbreviation	Definition
MAU	Major Assessable Unit
MD&A	Management's Discussion and Analysis
MHPI	Military Housing Privatization Initiative
MICP	Managers' Internal Control Program
MILCON	Military Construction
MMRP	Military Munitions Response Program
MOA	Memorandum of Agreement
MSC	Military Sealift Command
MUHIF	Military Unaccompanied Housing Improvement Fund
MW	Material Weakness
NAE	Navy Acquisition Executive
NAFI	Non-Appropriated Funds Instrumentalities
NAVAIR	Naval Air Systems Command
NAVAUDSVC	Naval Audit Service
NAVFAC	Naval Facilities Engineering Command
NAVINSGEN	Naval Inspector General
NAVSEA	Naval Sea Systems Command
NAVSUP	Naval Supply Systems Command
NAVWAR	Naval Information Warfare Systems Command
NAWC	Naval Air Warfare Centers
NCIS	Naval Criminal Investigative Service
NDS	National Defense Strategy
NDSF	Naval Facilities Engineering Service Center
NFESC	Notice of Findings and Recommendations
NIA	Naval Intelligence Activity
NIWC	Naval Information Warfare Centers
NMAC	Navy Materiel Accountability Campaign
NRL	Naval Research Laboratory
NRV	Net Realizable Value
NSWC	Naval Surface Warfare Centers
NUWC	Naval Undersea Warfare Centers
O&M	Operations and Maintenance
OA	Operating Agreement
OAD	Office of the Secretary of Defense
OASD	Office of Assistant Secretary of Defense
OCFP	Outstanding Contract Financing Payments
OCIO	Office of the Chief of Information Officer
OCMO	Office of the Chief Management Officer
OEL	Office of the Judge Advocate General

APPENDIX
NAVY | FISCAL YEAR 2020 AGENCY FINANCIAL REPORT

Abbreviation	Definition
OGC	Office of General Counsel
OJAG	Office of the Judge Advocate General
OM&S	Operating Materials & Supplies
OM&S-R	OM&S Remainder
OMB	Office of Management and Budget
ONR	Office of Naval Research
OPM	Office of Personnel Management
OSBP	Office of Small Business Programs
OUSD	Office of the Undersecretary of Defense
OUSD(C)	Office of the Undersecretary of Defense, Comptroller
P3s	Public-Private Partnerships
POM	Program Objective Memorandum
PRV	Plant Replacement Valuation
RMF	Risk Management Framework
S&T	Science and Technology
SABRS	Standard Accounting, Budgeting, and Reporting System
SARA	Superfund Amendments and Reauthorization Act
SBR	Statement of Budgetary Resources
SCNP	Statement of Changes in Net Position
SD	Significant Deficiencies
SECDEF	Secretary of Defense
SECNAV	Secretary of the Navy
SES	Senior Executive Service
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SMC	Senior Management Council
SMS	Sustainment Management System
SNC	Statement of Net Cost
SNF	Spent Nuclear Fuel
SOA	Statement of Assurance
SOD	PP&E
SSP	Strategic Systems Program
S&T	Science and Technology
SWS	Strategic Weapons Systems
SYSCOMs	System Commands
TAS	Treasury Accounting Symbol
TDD	Treasury Direct Disbursing
TFM	Treasury Financial Manual
TNC	Treasury Nominal Coupon

Abbreviation	Definition
TR	Technical Release
U.S.	United States of America
UAE	Uninstalled Aircraft Engines
UCC	Unified Combatant Command
UNSECNAV	Under Secretary of Navy
USACE	U.S. Army Corps of Engineers
USC	United States Code
USD(P&R)	Under Secretary of Defense for Personnel and Readiness
USFLTFORCOM	U.S. Fleet Forces Command
USMC	United States Marine Corps
USN	United States Navy
WCF	Working Capital Fund
WHO	World Health Organization
WIP	Work in Process

Cover images above are described from left to right and top to bottom as follows:

1. STRAIT OF HORMUZ (Sept. 18, 2020) The aircraft carrier USS Nimitz (CVN 68) and the guided-missile cruiser USS Philippine Sea (CG 58) steam in formation during a Strait of Hormuz transit.
2. NORFOLK (May 13, 2020) Cmdr. Stephen Lamoure, left, commanding officer of Fleet Area Control and Surveillance Facility, Virginia Capes (FACSFAC VACAPES), greets Cmdr. John Ciganovich, after receiving command of FACSFAC VACAPES during an aerial change of command ceremony.
3. GREAT LAKES, Ill. (Sept. 21, 2020) Recruits practice line-handling procedures inside the USS Arleigh Burke recruit barracks as part of the hands-on learning curriculum at Recruit Training Command.
4. PORT HUENEME, Calif. (June 3, 2020) Construction Electrician Constructionman Matthew Torregrossa, top, and Builder Construction-man Andrew Busken, assigned to Naval Mobile Construction Battalion (NMCB) 4, place straps around a landing roller cross girder to lift it off the bridge.
5. PHILIPPINE SEA (June 17, 2020) Aviation Ordnance Airman Apprentice Kristina Flores, right, from Fort Worth, Texas, and Aviation Electronics Technician Airman Adesina Semple, from Berbice, New York, clean the canopy of a F/A-18E Super Hornet attached to the Royal Maces of Strike Fighter Squadron (VFA) 27 on the flight deck of the Navy's only forward-deployed aircraft carrier USS Ronald Reagan (CVN 76).
6. PACIFIC OCEAN (May 12, 2020) The aircraft carrier USS Nimitz (CVN 68) conducts a replenishment-at-sea with the fleet replenishment oiler USNS Henry J. Kaiser (T-AO 187). The Nimitz Carrier Strike Group is underway conducting a composite unit training exercise (COMPTUEX).
7. (Oct 16, 2019) U.S. Marines and Sailors man the rails aboard the USS Somerset while transiting the San Francisco Bay during San Fran-cisco Fleet Week 2019. San Francisco Fleet Week is an opportunity for the American public to meet their Navy, Marine Corps and Coast Guard teams and experience America's sea services.
8. PACIFIC OCEAN (May 12, 2020) An MH-60S Sea Hawk, from to the "Screamin' Indians" of Helicopter Sea Combat Squadron (HSC) 6, conducts a vertical replenishment-at-sea with the fleet replenishment oiler USNS Henry J. Kaiser (T-AO 187) and the aircraft carrier USS Nimitz (CVN 68).
9. (Oct 29, 2019) U.S. Marines with Marine Wing Support Squadron 172, 1st Marine Aircraft Wing, III Marine Expeditionary Force board a CH-53E Super Stallion helicopter during a rapid deployment exercise conducted by 1st MAW, Okinawa, Japan.
10. MEDITERRANEAN SEA (June 16, 2020) Sailors assigned to the amphibious assault ship USS Bataan (LHD 5) parade the colors during a change of command ceremony on the flight deck.
11. ATLANTIC OCEAN (Aug. 21, 2020) Command Master Chief Kevin Guy, left, performs a spot inspection in the engineering main machinery room aboard the amphibious assault ship USS Wasp (LHD 1).
12. (Jan 22, 2020) Marines move into position to begin a simulated beach raid at Kin Blue, Okinawa, Japan.
13. (Feb 27, 2019) The Independence variant littoral combat ships USS Independence (LCS 2), left, USS Manchester (LCS 14), center, and USS Tulsa (LCS 16), right, sail in formation in the eastern Pacific..

www.navy.mil | www.marines.mil

FOR MORE INFORMATION

Assistant Secretary of the Navy Financial Management and Comptroller
https://www.secnav.navy.mil/fmc/pages/default.aspx

CONTACT US

An electronic copy of this report is available at
https://www.secnav.navy.mil/fmc/fmo/Pages/Financial-Reports.aspx